Supreme Court, U.S.
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No.

IN THE
Supreme Court of the United States

CONNECTICUT GENERAL LIFE INSURANCE COMPANY, *et al.*,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether an administrative interpretation of an ambiguous tax regulation, advanced by IRS counsel as a litigating position in the United States Tax Court, is entitled to deference.

PARTIES TO THE PROCEEDINGS

The parties below were petitioner Connecticut General Life Insurance Company (appellant below), petitioner CIGNA Corporation and Consolidated Subsidiaries (appellant below), and respondent Commissioner of Internal Revenue (appellee below).

Connecticut General Life Insurance Company is a wholly-owned subsidiary of CIGNA Corporation, a publicly held company with no parent or publicly held company owning 10 percent or more of its stock. All of the other consolidated subsidiaries at issue are or were wholly-owned subsidiaries of CIGNA Corporation.

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

PARTIES TO THE PROCEEDINGS ii

TABLE OF AUTHORITIES v

OPINIONS BELOW 1

JURISDICTION 1

PERTINENT PROVISIONS 1

STATEMENT OF THE CASE 1

REASONS FOR GRANTING THE WRIT 8

I. THE DECISION BELOW CREATES TWO INDEPENDENT CIRCUIT SPLITS 9

A. The Courts Of Appeals Are Divided On Whether *Bowen* Applies To Agency Litigating Positions Interpreting Ambiguous Regulations, As Opposed To Statutes 9

B. The Courts Of Appeals Are Divided On The Appropriate Interpretive Principle For Resolving Ambiguity In The Context Of Tax Law 12

C. These Splits Are Exacerbated By The Multi-Track Scheme For Judicial Enforcement Of Federal Tax Liabilities 14

II. THE DECISION BELOW CONFLICTS WITH BASIC ADMINISTRATIVE LAW AND TAX PRINCIPLES ADOPTED BY THIS COURT 16

A. Agency Litigating Positions, Whether Interpreting Ambiguous Statutes Or Regulations, Are Not Entitled To Deference 16

TABLE OF CONTENTS (cont'd)

B. This Court Has Long Held That Ambiguous Tax Provisions Must Be Construed In Favor Of The Taxpayer 21

C. *Gardebring* Provides No Support For The Court Of Appeals' Holding 22

III. IF NOT CORRECTED, THE DECISION BELOW WILL HAVE SWEEPING AND TROUBLING CONSEQUENCES 23

CONCLUSION 27

TABLE OF AUTHORITIES

Page

Cases

Adams Fruit Co. v. Barrett, 494 U.S. 638 (1990) 17
Allen v. Atlanta Metallic Casket Co., 197 F.2d 460 (5th Cir. 1952) 14
AMP Incorporated and Consolidated Subsidiaries v. United States, No. 98-5083, 1999 WL587934 (Fed. Cir. Aug. 2, 1999) 12
Auer v. Robbins, 519 U.S. 452 (1998) 23
Bowen v. Georgetown University Hosp., 488 U.S. 204 (1988) 7, 10, 12, 17
Bowles v. Seminole Rock & Sand Co., 325 U.S. 410 (1945) 16
Bradberry v. Director, Office of Workers' Compensation Programs, 117 F.3d 1361 (11th Cir. 1997) 11
Brewster v. Sullivan, 972 F.2d 898 (8th Cir. 1992) 11
Burnet v. Niagara Falls Brewing Co., 282 U.S. 648 (1931) 22
CIR v. Estate of Hubert, 520 U.S. 93 (1997) 24
CSI Hydrostatic Testers, Inc. v. CIR, 62 F.3d 136 (5th Cir. 1995) (per curiam) 10
CSI Hydrostatic Testers, Inc. v. CIR, 103 T.C. 398 (1994), *aff'd*, 62 F.3d 136 (5th Cir. 1995) (per curiam) 10
Chevron U.S.A., Inc. v. Natural Resources Defense Council, 467 U.S. 837 (1984) 16
City of Chicago v. Environmental Defense Fund, 511 U.S. 328 (1994) 24
Cottage Savings Association v. CIR, 499 U.S. 554 (1991) 18
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TABLE OF AUTHORITIES (cont'd)

Ford Motor Credit Co. v. Milhollin, 444 U.S. 555 (1980) 20
Freytag v. CIR, 501 U.S. 868 (1991) 19, 26
Gardebring v. Jenkins, 485 U.S. 415 (1988) 7, 22
Golsen v. Commissioner, 54 T.C. 742 (1970), *aff'd*, 445 F.2d 985 (10th Cir.), *cert. denied*, 404 U.S. 940 (1971) 15
Gould v. Gould, 245 U.S. 151 (1917) 13, 14, 21
Greyhound Corp. v. United States, 495 F.2d 863 (9th Cir. 1974) 14
Harco Holdings, Inc. v. United States, 977 F.2d 1027 (7th Cir. 1992) 9, 10
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Lilly v. United States, 238 F.2d 584 (4th Cir. 1956) . . . 14
Longhi v. Animal & Plant Health Inspection Service, 165 F.3d 1057 (6th Cir. 1999) 11
Martin v. Occupational Safety & Health Review Commission, 499 U.S. 144 (1991) 17, 18
McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819) 21
McKee v. Sullivan, 903 F.2d 1436 (11th Cir. 1990) . . . 11
Metropolitan Stevedore Co. v. Rambo, 521 U.S. 121 (1995) 24
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Pauley v. Bethenergy Mines, Inc., 501 U.S. 680 (1991) 17
Reinecke v. Northern Trust Co., 278 U.S. 339 (1929) . . 21
Security Bank Minnesota v. CIR, 994 F.2d 432 (8th Cir. 1993) 13
Shalala v. Guernsey Memorial Hospital, 514 U.S. 87 (1995) 24
Smiley v. Citibank (South Dakota), N.A., 517 U.S. 735 (1996) 17

TABLE OF AUTHORITIES (cont'd)

Stinson v. United States, 508 U.S. 36 (1993) 23
Stutson v. United States, 516 U.S. 163 (1996) 18
Thomas Jefferson University v. Shalala, 512 U.S. 504 (1994) 25
Union Pacific Corp. v. United States, 5 F.3d 523 (Fed. Cir. 1993) 14
United States v. Larionoff, 431 U.S. 864 (1977) 23
United States v. Merriam, 263 U.S. 179 (1923) 22
United States v. Trident Seafoods Corp., 60 F.3d 556 (9th Cir. 1995) 11
United Transportation Union v. Dole, 797 F.2d 823 (10th Cir. 1986) 12
Weingarden v. CIR, 825 F.2d 1027 (6th Cir. 1987) 13
White v. Aronson, 302 U.S. 16 (1937) 22
William Brothers, Inc. v. Pate, 833 F.2d 261 (11th Cir. 1987) 10, 20
Xerox Corp. v. United States, 41 F.3d 647 (Fed. Cir. 1994), *cert. denied*, 516 U.S. 817 (1995) 14

Statutes

26 U.S.C. § 312(1) 10
26 U.S.C. § 801 ..... 2, 9
26 U.S.C. § 892 7
26 U.S.C. § 1232 7
26 U.S.C. § 1281 13
26 U.S.C. § 1501 ..... 1, 2
26 U.S.C. § 1502 ..... 1, 2, 19, 26
26 U.S.C. § 1503 ..... *passim*
26 U.S.C. § 1504 ..... 1, 2
26 U.S.C. § 1505 1
26 U.S.C. § 6213 ..... 6, 15
26 U.S.C. § 6214 6
26 U.S.C. § 7441 19

TABLE OF AUTHORITIES (cont'd)

26 U.S.C. § 7442 6
26 U.S.C. § 7482 ..... 6, 15
28 U.S.C. § 1254(1) 1
28 U.S.C. § 1295(a)(3) 13
28 U.S.C. § 1346(a)(1) 15

Rules and Regulations

20 C.F.R. § 404.721(b) 11
26 C.F.R. § 1.163-8T(h) 7
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26 C.F.R. § 1.1502-32 10
26 C.F.R. § 1.1502-47 ..... 1, 3, 5, 8, 20
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47 Fed. Reg. 24,737 (1982) 3
Filing of Life-Nonlife Consolidated Returns, 48 Fed. Reg. 11436 (1983) 4, 5
T.D. 7311, 1974-1 C.B. 234 7
T.D. 8145, 1987-2 C.B. 47 7

Miscellaneous

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Technical Advice Memorandum 8533003 (May 7, 1985) 7

PETITION FOR A WRIT OF CERTIORARI

Connecticut General Life Insurance Company and CIGNA Corporation and Consolidated Subsidiaries respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a) is reported at 177 F.3d 136. The opinion of the tax court (Pet. App. 24a) is reported at 109 T.C. 100.

JURISDICTION

The judgment of the court of appeals was entered on April 30, 1999. On July 20, 1999, Justice Souter extended the time for filing this petition to and including August 12, 1999. This Court has jurisdiction under 28 U.S.C. § 1254(1).

PERTINENT PROVISIONS

Pertinent provisions of 26 U.S.C. §§ 1501-1505 and 26 C.F.R. § 1.1502-47 are reproduced at Pet. App. 39a.

STATEMENT OF THE CASE

This case involves interpretation of the statutes and regulations that govern the filing of consolidated federal income tax returns by affiliated companies. As the court of appeals acknowledged, these provisions are ambiguous on the specific question whether a parent company, if it has a life insurance subsidiary, can offset the income and losses of other subsidiaries recently acquired as a group. Petitioners filed tax returns based on a reasonable interpretation of the provisions at issue to permit such offsetting. During subsequent litigation against petitioners in the United States Tax Court, counsel for the Internal Revenue Service ("IRS") asserted the opposite interpretation. The question presented is whether, as the court

of appeals held, that agency litigating position is entitled to deference.

1. The Internal Revenue Code generally permits affiliated corporations to file a single "consolidated" income tax return on which, in order to reduce overall taxable income, the income of one affiliated corporation may be offset by the losses of another. 26 U.S.C. § 1501. The Code authorizes the Secretary of the Treasury to promulgate regulations under which the tax liability of an affiliated group of corporations can be appropriately computed. *Id.* § 1502. Prior to 1976, however, the Code specifically prohibited life insurance companies ("life companies") from filing consolidated returns with affiliated other companies ("nonlife companies"). Pet. App. 2a.

The Tax Reform Act of 1976 substantially loosened the restrictions against this so-called "life-nonlife" consolidation. That Act amended the Code to permit affiliated life and nonlife companies to file consolidated income tax returns for tax years beginning in 1981. *See* 26 U.S.C. § 1504(c)(2). However, the Act also imposed certain restrictions on the extent of offsetting losses within a group of affiliated life and nonlife companies. The provision directly at issue here states that the losses of a nonlife member "shall not be taken into account in determining the taxable income of a member taxed under section 801" (*i.e.*, a life member),[1] if the life member and the nonlife member have been affiliated for five years or less. *Id.* § 1503(c)(2).[2]

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[1] Section 801 of the Code, 26 U.S.C. § 801, applies only to life insurance companies.

[2] Section 1503(c)(2) provides:

> *Losses of recent nonlife affiliates.* — Notwithstanding the provisions of paragraph (1), a net operating loss for a taxable year of a member of the group not taxed under section 801 [*i.e.*, a nonlife

2. Acting pursuant to § 1502, the Secretary has promulgated an elaborate regulation addressing life-nonlife consolidation. 26 C.F.R. § 1.1502-47. One provision of that regulation defines "[l]osses of a nonlife member" within the five-year period referred to in § 1503(c)(2) as "ineligible," and further provides that such "ineligible" losses "may not be used under section 1503(c)(2) and paragraph (m) of this section to set off the income of a life member." *Id.* § 1.1502-47(d)(13). Paragraph (m) in turn contains two relevant provisions. One provision, titled "[i]neligible nonlife member," states in pertinent part that "ineligible" net operating losses ("NOL") may not "be set off against consolidated partial LICTI" (*i.e.*, life insurance company taxable income). *Id.* § 1502-47(m)(3)(vi). It further states that, "[f]or purposes of this subparagraph (3), the 'ineligible NOL' is in the year the loss arose the amount of the separate net operating loss . . . of any nonlife member that is ineligible in that year." *Id.* The other relevant provision states as follows: "*Acquired groups.* [Reserved]." *Id.* § 1.1502-47(m)(4) (brackets in original).

As originally drafted, the proposed regulations contained a predecessor of the "[i]neligible nonlife member" provision ultimately codified in paragraph (m)(3)(vi), but omitted the "[a]cquired groups" provision ultimately codified in paragraph (m)(4). *See* 47 Fed. Reg. 24,737, 24,748 (1982). In response to the proposed regulations, commenters (including

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member] shall not be taken into account in determining the taxable income of a member taxed under section 801 [*i.e.*, a life member] (either for the taxable year or as a carryover or carryback) if such taxable year precedes the sixth taxable year such members have been members of the same affiliated group (determined without regard to section 1504(b)(2)).

Section 1503(c)(1), 26 U.S.C. § 1503(c)(1), imposes other restrictions on the extent of permissible offsetting. Those restrictions are not at issue in this case.

petitioners) noted that paragraph (m)(3)(vi), read in isolation, might be construed to prohibit not only offsetting nonlife losses against life income, but also offsetting nonlife losses against *non*-life income, even among the members of a recently-acquired group that had previously filed a consolidated tax return and, accordingly, had previously engaged in such offsetting. Pet. App. 5a-6a. In direct response to that criticism, the proposed regulations were modified in three distinct ways. First, paragraph (m)(4) was added to reserve the "[a]cquired groups" issue. Second, the definition of "ineligible" nonlife losses was restricted to "subparagraph (3)," which addresses nonlife losses generally, and thus made inapplicable to subparagraph (4), which addresses "acquired group[s]" in particular. Third, the regulatory preamble was amended to record the Secretary's deliberate agnosticism on the appropriate treatment of acquired groups:

> [T]he Treasury Department will study further whether it is appropriate to aggregate the income and losses of ineligible members in certain cases. For instance, notwithstanding the ordinary reading of section 1503(c)(2), it may be consistent with the intent of section 1503(c)(2), or correct as a matter of policy, to aggregate the income and losses of ineligible members that filed a consolidated return prior to their acquisition by (and includability in) another group that files a consolidated return.

Filing of Life-Nonlife Consolidated Returns, 48 Fed. Reg. 11436, 11440 (1983).

3. Connecticut General Corporation was formerly the common parent of one life company, petitioner Connecticut General Life Insurance Company ("CGL"), and more than forty affiliated nonlife companies (collectively the "CG Group"). In 1981, the CG Group began to file a single consolidated income tax return, as permitted by the Tax Reform Act of 1976. At the same time, INA Corporation was

the common parent of over 160 affiliated nonlife companies (collectively the "INA Group"). The INA Group also filed a single consolidated income tax return. On March 31, 1982, the CG and INA Groups combined and organized petitioner CIGNA Corporation as their parent holding company. Pet. App. 3a-4a. Subsequently, a CIGNA subsidiary acquired Preferred Health Care, Incorporated, the common parent of several affiliated nonlife companies (collectively the "PHC Group"). Prior to its acquisition by CIGNA, the PHC Group also had filed a single consolidated income tax return. Pet. App. 4a. For federal income tax purposes, the CG Group was deemed to have acquired the INA Group, and CIGNA was deemed to have acquired the PHC Group. *Id.*

In preparing its consolidated income tax returns for tax years 1982 through 1985, CIGNA interpreted paragraph (m)(3)(vi) and (m)(4) only to prohibit offsetting the nonlife losses of recently acquired affiliates against the *life* income of CGL, but not to prohibit offsetting these nonlife losses against *non*-life income among companies that constituted the INA and PHC groups respectively. CIGNA's interpretation rested on several considerations: the underlying statutory rule that "[l]osses of recent nonlife affiliates . . . shall not be taken into account in determining the taxable income of a member taxed under section 801" (*i.e.*, a *life* member), 26 U.S.C. § 1503(c)(2); the definitional provision that losses of an "ineligible" nonlife member cannot be used "to set off the income of a *life* member," 26 C.F.R. § 1.1502-47(d)(13) (emphasis added); the references in paragraph (m)(3)(vi) to nonlife losses as "ineligible" for the specific purpose of being "set off against consolidated partial LICTI" (*i.e.*, *life* insurance company taxable income); the explicit reservation in paragraph (m)(4) of the "[a]cquired groups" issue; and the preamble's statement that it might be "correct" to "aggregate the income and losses of ineligible members that filed a consolidated return prior to their acquisition," *see* 48 Fed. Reg. at 11440.

CIGNA followed the offsetting method suggested in the final regulatory preamble. Because the losses of its INA and PHC members were ineligible under § 1503(c)(2), CIGNA did not use even one penny of those losses to determine or offset the income of its sole *life* member, CGL. On the other hand, CIGNA did use the nonlife losses of the unprofitable INA and PHC affiliates to offset the *nonlife* income of the profitable INA and PHC affiliates. Pet. App. 7a-8a.

4. On June 23, 1992, the Commissioner of Internal Revenue filed notices of deficiency alleging that petitioners owed the federal government $62,176,665 in unpaid income taxes and what is over $150,000,000 in interest. Pet. App. 10a-11a.[3] Petitioners sought a redetermination of the deficiency in the United States Tax Court pursuant to 26 U.S.C. § 6213(a).[4] During the ensuing litigation, counsel for the IRS asserted that paragraph (m)(3)(vi) barred CIGNA from offsetting the nonlife losses of INA and PHC affiliates not only against the life income of CGL, but also against the nonlife income of other INA and PHC affiliates. Prior to the litigation, the IRS had never before advanced this position in any regulation, ruling, or administrative practice. On a stipulated record, the tax court judge endorsed the interpretation of IRS counsel and granted summary judgment to the Commissioner. Pet. App. 24a-38a.

5. The Third Circuit affirmed.[5] At the outset of its analysis, the court of appeals acknowledged the settled rule that courts do not give any deference to agency litigating positions that are unsupported by prior "'regulations, rulings,

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[3] The notice of deficiency involved different tax years, but the same underlying dispute. Pet. App. 10a & n.1.

[4] The tax court had original jurisdiction in this case under 26 U.S.C. §§ 6214(a) and 7442.

[5] The court of appeals had jurisdiction under 26 U.S.C. § 7482(a)(1).

or administrative practice.'" Pet. App. 13a, quoting *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 212 (1988). However, the court of appeals concluded that *Bowen* governs only the question of the "deference due an administrative agency's informal interpretation of a *statute*," but "does not address what deference we should accord an agency's interpretation of its own *regulations*." Pet. App. 15a (emphases added). On the latter question, the court of appeals held that *Gardebring v. Jenkins*, 485 U.S. 415 (1988), mandates deference "to an agency's interpretation of its own regulations, even when that interpretation was proffered for the first time in litigation." Pet. App. 15a. Accordingly, the court announced that it would "defer" to the IRS's litigating position in this case, unless CIGNA's competing position was "'compelled'" by the "'plain language'" of the regulations in question. *Id.* (quoting *Gardebring*, 485 U.S. at 430).

The court then concluded that the competing interpretations asserted by CIGNA and by IRS counsel were "equally likely." Pet. App. 16a. The court reasoned that paragraph (m)(4) could be construed either to reserve the "subject matter" of acquired groups, as CIGNA argued, or to reserve only "space" for some regulation that might hypothetically be promulgated in the future, as argued by counsel for the IRS. Pet. App. 15a.[6] Similarly, the court

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[6] As the court of appeals acknowledged (Pet. App. 16a), the IRS often uses the term "reserved" to make clear that related regulations are inapplicable. *See*, e.g., T.D. 8145, 1987-2 C.B. 47, 49, 56 (question "reserved" in 26 C.F.R. § 1.163-8T(h) "is not addressed" in regulations because IRS "is still studying" the relevant issues); T.D. 7311, 1974-1 C.B. 234 (regulations under 26 U.S.C. § 1232 inapplicable to "reserved" subject matter); Technical Advice Memorandum 8533003 (May 7, 1985) (same for regulations under 26 U.S.C. § 892). In concluding that paragraph (m)(4) can reasonably be construed to have no substantive significance, but to reserve only space in a numbering sequence, the court of appeals relied on a government handbook published in 1991, eight years after the consolidation regulations were actually promulgated. Pet.

concluded that there was "nothing unreasonable" with the restrictive interpretation of the preamble urged by counsel for the IRS. Pet. App. 17a. The court therefore deferred to the IRS's litigating position: "Because the interpretation advanced by the IRS is neither inconsistent with any prior interpretation of these regulations nor incompatible with their plain text, we defer to that interpretation." Pet. App. 18a; *see also* Pet. App. 23a (IRS "interpretation of that regulation is not so unreasonable as to be declared invalid by this court").

REASONS FOR GRANTING THE WRIT

This case turns on the extent of offsetting permitted under 26 U.S.C. § 1503(c)(2) and its implementing regulation, 26 C.F.R. § 1.1502-47(m)(3)(vi) and (m)(4). The court of appeals did not hold that the IRS's litigating position constitutes the *only* reasonable reading of these provisions, or even the *most* reasonable reading. Instead, it concluded that the competing interpretations asserted by IRS counsel and by CIGNA were "equally likely" (Pet. App. 16a), and it deferred to the government's interpretation on the sole ground that it was not "unreasonable" (Pet. App. 17a, 23a). This Court should review that deference holding for several reasons: it creates two independent splits of authority in the courts of appeals, it is inconsistent with numerous decisions of this Court, and it addresses administrative law and tax questions of surpassing practical importance in this and thousands of other cases.

App. 16a. When those regulations were actually promulgated, however, the available edition of the same handbook did not discuss the term "reserved." *See generally* Office of Federal Register, *Federal Register Document Drafting Handbook* (rev. ed. 1980).

I. THE DECISION BELOW CREATES TWO INDEPENDENT CIRCUIT SPLITS

The decision below creates circuit splits on important and related questions of administrative law and taxation. The administrative law question involves whether agency litigating positions are entitled to deference. The tax question involves competing interpretive principles for resolving ambiguity in the specific context of tax law. This Court should grant review to resolve those splits.

A. The Courts Of Appeals Are Divided On Whether *Bowen* Applies To Agency Litigating Positions Interpreting Ambiguous Regulations, As Opposed To Statutes

In *Bowen*, this Court held that "[d]eference to what appears to be nothing more than an agency's convenient litigating position would be entirely inappropriate." 488 U.S. at 213. Accordingly, the Court concluded, courts must not defer to "agency litigating positions that are wholly unsupported by regulations, rulings, or administrative practice." *Id.* at 212-13. Despite the breadth of this Court's language, the court of appeals explicitly restricted *Bowen* to agency litigating positions interpreting ambiguous statutes, and explicitly held *Bowen* inapplicable to agency litigating positions interpreting ambiguous regulations. Pet. App. 15a. At least five other courts of appeals, however, have held that *Bowen* applies to both kinds of agency litigating positions.

In *Harco Holdings, Inc. v. United States*, 977 F.2d 1027 (7th Cir. 1992), the Seventh Circuit applied *Bowen* to reject an IRS litigating position interpreting the term "unpaid losses" as used in 26 U.S.C. § 801(a)(2) and 26 C.F.R. § 1.801-3(g) (1991). In its analysis, the court specifically noted that there was "sufficient ambiguity in the statute *and the regulations* that we might defer to the Service's interpretation." 977 F.2d at 1035 (emphasis shifted). However, the court concluded,

such deference "does not apply to 'agency litigating positions that are wholly unsupported by regulations, rulings, or administrative practice.'" *Id.* (quoting *Bowen*, 488 U.S. at 212). Applying *Bowen*, the court held that, because the IRS's interpretation "of section 801 and regulation 1.801-3(g)" was "new and unsupported by agency practice or rulings," it "deserve[d] no deference." *See id.* at 1035-36.

The Fifth Circuit adopted an identical position in *CSI Hydrostatic Testers, Inc. v. CIR*, 62 F.3d 136 (5th Cir. 1995) (per curiam). That case applied *Bowen* to reject an IRS litigating position interpreting 26 U.S.C. § 312(1) and 26 C.F.R. § 1502-32. The tax court in *CSI Hydrostatic*, despite acknowledging the general rule that "an agency's interpretation of its own regulation is entitled to deference," concluded that, "in the absence of a contrary published, or at least longstanding, interpretation of the regulation in question, deference is not the rule." 103 T.C. 398, 408-09 (1994) (citing *Bowen*, 488 U.S. at 212); *see also id.* at 409 ("[U]nless an agency's interpretation of a statute *or a regulation* is a matter of public record and is an interpretation on which the public is entitled to rely when planning their affairs, it will not be accorded any special deference." (emphasis added)). Applying that principle, the tax court did not give "any deference" to the IRS's litigating position. *Id.* at 409. On appeal, the Fifth Circuit explicitly "adopt[ed] that opinion." 62 F.3d at 136 ("We agree with the tax court's thorough opinion . . . .").

The Eleventh Circuit also has refused to defer to agency litigating positions interpreting ambiguous regulations. *William Brothers, Inc. v. Pate*, 833 F.2d 261 (11th Cir. 1987), involved interpretation of the term "coal mine dust" as used in the Black Lung Benefits Act and its implementing regulation. Despite explicitly noting that the regulation in question was ambiguous (*id.* at 265 n. 2), the Eleventh Circuit refused to defer to an agency litigating position broadly construing that regulation. The court explained: "[W]e do not agree that the

Director's mere litigating position is entitled to be given deference. Common sense tells us that if deference were always given to the Director's litigating position, then claimants would be effectively denied the right to appellate review." *Id.* at 265; *accord, e.g., Bradberry v. Director, Office of Workers' Compensation Programs*, 117 F.3d 1361, 1366 (11th Cir. 1997) (no deference to agency "litigating position" interpreting ambiguous regulation); *McKee v. Sullivan*, 903 F.2d 1436, 1438 n.3 (11th Cir. 1990) (same, citing *Bowen*).

Finally, the Eighth and Ninth Circuits also have refused to give deference to agency litigating positions interpreting ambiguous regulations. In *Brewster v. Sullivan*, 972 F.2d 898, 900-02 (8th Cir. 1992), the Eighth Circuit refused to defer to an administrative interpretation regarding the elements of proof under 20 C.F.R. § 404.721(b). The court expressly "acknowledge[d] that as a general rule an agency's interpretation of its own regulation is entitled to great deference," but held that, nonetheless, "courts do not defer to an agency's litigating position." 972 F.2d at 901. Similarly, in *United States v. Trident Seafoods Corp.*, 60 F.3d 556, 558-59 (9th Cir. 1995), the Ninth Circuit refused to defer to an administrative interpretation of the Clean Air Act and its implementing regulations, despite explicitly concluding (*id.* at 558) that the regulation at issue was ambiguous. The court explained that its conclusion was "not inconsistent with the proposition that deference is ordinarily owed to an agency's interpretation of its own regulations," because "[n]o deference is owed when an agency has not formulated an official interpretation of its regulation, but is merely advancing a litigating position." *Id.* at 559.[7]

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[7] The Sixth Circuit also has strongly suggested that courts must not defer to an "'agency litigating position'" interpreting "existing regulations." *Longhi v. Animal & Plant Health Inspection Service*, 165 F.3d 1057, 1061

B. The Courts Of Appeals Are Divided On The Appropriate Interpretive Principle For Resolving Ambiguity In The Context Of Tax Law

In the tax context specifically, courts confronted with ambiguity must choose between two competing interpretive principles. In this case, the Third Circuit adopted and applied the principle that IRS litigating positions are entitled to deference, thus resolving all ambiguity in favor of the government. Several other courts of appeals, however, continue to apply the venerable and diametrically opposite principle that ambiguity should be resolved in favor of the taxpayer. This Court should grant review to determine which of these competing principles is appropriate.

In *Duke Energy Natural Gas Corp. v. CIR*, 172 F.3d 1255, 1259-61 (10th Cir. 1999), the Tenth Circuit recently refused to defer to an agency litigating position construing ambiguous terms in a controlling revenue procedure.[8] The court invoked and applied the principle that "'if doubt exists as to the construction of a taxing [provision], the doubt should be resolved in favor of the taxpayer.'" *Id.* at 1260 n. 7 (quoting *Hassatt v. Welch*, 303 U.S. 303, 314 (1938)). Finding "no

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(6th Cir. 1999) (quoting *Bowen*, 488 U.S. 212); *see also United Transportation Union v. Dole*, 797 F.2d 823, 831-32 (10th Cir. 1986) (Logan, J., concurring) (no deference to administrative interpretation of regulation because "there is nothing in the record to suggest that the agency has taken the position it now advocates before this litigation arose"). The Federal Circuit has extended these principles even farther. In *AMP Incorporated and Consolidated Subsidiaries v. United States*, No. 98-5083, 1999 WL 587934, at *5 (Fed. Cir. Aug. 2, 1999), that court refused to defer to an IRS interpretation of an ambiguous tax regulation expressed in a revenue ruling issued "at a time when the IRS is *preparing* to litigate" (emphasis added).

[8] A revenue procedure is a regulatory document "'published for the information and guidance' of taxpayers as well as the IRS." 172 F.3d at 1259 (quoting 26 C.F.R. § 601.601(d)(2)(i)(a)).

clear mandate" and no "explicit" support for the IRS's litigating position, the court rejected that position and construed the revenue procedure in favor of the taxpayer. *See id.* at 1260-61.

The same interpretive principle was also dispositive in *Security Bank Minnesota v. CIR*, 994 F.2d 432, 436 (8th Cir. 1993), in which the Eighth Circuit invoked and applied the rule that "when there is a reasonable doubt about the meaning of a revenue statute, the doubt is resolved in favor of those taxed." The court expressly concluded that the operative tax provision (26 U.S.C. § 1281) was "ambiguous" on the question presented. *Id.* at 437. In these circumstances, the court refused to defer to the IRS's litigating position:

> [B]ecause the application of § 1281 to these loans is ambiguous, we follow the venerable rule that "[i]n the interpretation of statutes levying taxes . . . [courts must not] enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt, they are construed most strongly *against* the Government, and in favor of the citizen."

Id. at 441 (quoting *Gould v. Gould*, 245 U.S. 151, 153 (1917) (emphasis added; other alterations by the *Security Bank* court)).

The Sixth Circuit adopted and applied the same approach in *Weingarden v. CIR*, 825 F.2d 1027 (6th Cir. 1987). That case too confirmed that "[t]he general canon of construction is that statutes imposing a tax are interpreted liberally (in favor of the taxpayer)." *Id.* at 1029. Faced with ambiguity, the Sixth Circuit applied that principle, and thus rejected the litigating position of the IRS. *See id.* ("we construe the hopeless ambiguity created by this statutory scheme in favor of the taxpayer").

Finally, the Federal Circuit, which has exclusive jurisdiction over all tax cases arising in the Court of Federal Claims (28

U.S.C. § 1295(a)(3)), repeatedly has made clear that IRS litigating positions are not entitled to deference. Like these other appellate courts, the Federal Circuit has concluded that ambiguity in tax provisions must be resolved not in favor of the agency litigating position, but in favor of the taxpayer. *See, e.g., Xerox Corp. v. United States*, 41 F.3d 647, 658 (Fed. Cir. 1994) ("As a special rule in tax cases, 'if doubt exists as to the construction of a taxing statute, the doubt must be resolved in favor of the taxpayer.'" (quoting *Hassett*, 303 U.S. at 314)), *cert. denied*, 516 U.S. 817 (1995); *Union Pacific Corp. v. United States*, 5 F.3d 523, 525 (Fed. Cir. 1993) ("the Supreme Court counsels to construe any reasonable doubts about the meaning of a tax statute in favor of the taxpayer" (citing *Gould*, 245 U.S. at 153)); *Ocean Drilling & Exploration Co. v. United States*, 988 F.2d 1135, 1157 (Fed. Cir. 1993) ("if there is a doubt as to the meaning of the provisions of the Internal Revenue Code, the doubt 'must be resolved in favor of the taxpayer'" (citation omitted)).[9]

C. These Splits Are Exacerbated By The Multi-Track Scheme For Judicial Enforcement Of Federal Tax Liabilities

Although circuit splits this deep would warrant the Court's attention in any event, the tax context presents two distinctive

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[9] Other courts of appeals have also invoked and applied these principles. *See, e.g., Greyhound Corp. v. United States*, 495 F.2d 863, 869 (9th Cir. 1974) ("Here, it is proper to invoke the well known rule of construction that in cases of doubt, a taxing statute must be construed most strongly in favor of the taxpayer and against the government."); *Lilly v. United States*, 238 F.2d 584, 587 (4th Cir. 1956) ("It is well settled that taxing statutes are strictly construed against the government and in favor of the taxpayer."); *Allen v. Atlanta Metallic Casket Co.*, 197 F.2d 460, 461 (5th Cir. 1952) (applying "the principle that taxes may not be exacted unless clearly due, and in case there is doubt, the taxpayer must be given the benefit of it").

features that make review even more essential to the proper functioning of the federal judicial system.

First, decisions of the tax court are appealable to the regional courts of appeals in which the taxpayer has its legal residence or principal place of business. 26 U.S.C. § 7482(b). The residence of the taxpayer thus determines, in any particular case, what body of appellate precedent is binding on the tax court. *See Golsen v. Commissioner*, 54 T.C. 742, 756-57 (1970), *aff'd*, 445 F.2d 985 (10th Cir.), *cert. denied*, 404 U.S. 940 (1971). Therefore, when the courts of appeals are divided, the consequence is not only disparate results among *different* courts, but, even worse, disparate results within the *same* court. *See, e.g.*, N. Crimm, *Tax Court Litigation: Practice and Procedure* ¶ 2.4[2][g], at 2-101 (1999) ("[T]he *Golsen* rule means that cases before the Tax Court involving similar facts and identical legal issues result in inconsistent conclusions when the separate circuit courts have treated the issues in differing manners.").

Second, taxpayers have a choice from among three possible judicial fora: if a taxpayer declines to pay an alleged deficiency, it may seek a "redetermination" of the deficiency in the tax court (26 U.S.C. § 6213(a)); on the other hand, if a taxpayer elects to pay the alleged deficiency, it may seek "recovery" of the disputed amount either in an appropriate district court or in the Court of Federal Claims (28 U.S.C. § 1346(a)(1)). Given the decision below, a shrewd and affluent Philadelphia taxpayer will pay the deficiency and litigate for "recovery" in the Court of Federal Claims, thus purchasing favorable Federal Circuit precedent under which all ambiguous regulations are construed in favor of the taxpayer. On the other hand, an unwise or impecunious Philadelphia taxpayer might still seek (or be forced to seek) a "redetermination" in the tax court, subject to the unfavorable precedent that all ambiguous regulations are construed in

favor of IRS litigating positions. This Court should not tolerate circuit splits that invite such law-shopping.

II. THE DECISION BELOW CONFLICTS WITH BASIC ADMINISTRATIVE LAW AND TAX PRINCIPLES ADOPTED BY THIS COURT

The court of appeals concluded that, where a tax regulation is ambiguous, courts must defer to any minimally reasonable interpretation asserted by IRS counsel in litigation before the tax court. Pet. App. 13a-15a. That conclusion conflicts with scores of this Court's administrative law and tax cases. Moreover, the court of appeals erred in asserting that *Gardebring* even remotely supports this startling result.

A. Agency Litigating Positions, Whether Interpreting Ambiguous Statutes Or Regulations, Are Not Entitled To Deference

Under basic administrative law principles, courts generally must defer to an agency's reasonable interpretation of an ambiguous statute, *see, e.g., Chevron U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 842-44 (1984), or an ambiguous regulation, *see, e.g., Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 413-14 (1945), that the agency is entrusted to administer. Under *Bowen*, however, *Chevron* deference is "entirely inappropriate" when the only administrative interpretation at issue is a "litigating position" asserted by agency counsel. *See* 488 U.S. at 212-13. There is no conceivable reason why the opposite rule should apply to agency litigating positions asserted to warrant deference under *Seminole Rock*.

1. The justifications for *Chevron* and *Seminole Rock* are identical. *Chevron* reflects an interpretive presumption that, because of an agency's relative expertise and political accountability, "Congress, when it left ambiguity in a statute meant for implementation by an agency, understood that the ambiguity would be resolved, first and foremost, by the

agency." *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735, 740-41 (1996); *accord, e.g., Adams Fruit Co. v. Barrett*, 494 U.S. 638, 649 (1990) ("A precondition to deference under *Chevron* is a congressional delegation of administrative authority."). The justification for *Seminole Rock* deference is essentially identical: "Because applying an agency's regulation to complex or changing circumstances calls upon the agency's unique expertise and policymaking prerogatives, we presume that the power authoritatively to interpret its own regulations is a component of the agency's delegated lawmaking powers." *Martin v. Occupational Safety & Health Review Comm'n*, 499 U.S. 144, 151 (1991); *accord, e.g., Pauley v. Bethenergy Mines, Inc.*, 501 U.S. 680, 696-97 (1991) (*Chevron* analysis "informs our determination that deference [under *Seminole Rock*] is appropriate"); Manning, *Constitutional Structure and Judicial Deference To Agency Interpretations of Agency Rules*, 96 Colum. L. Rev. 612, 613 (1996) (*Chevron* and *Seminole Rock* doctrines "are functionally similar"); Anthony, *The Supreme Court and the APA: Sometimes They Just Don't Get It*, 10 Admin. L.J. Am. U. 1, 5 (1996) ("there should be no difference for present purposes between interpretations of regulations and interpretations of statutes"). Given the functional and analytical similarities between these deference doctrines, it is highly implausible that they should apply differently in the context of agency litigating positions.

In *Bowen* and its progeny, this Court repeatedly has refused to defer to agency litigating positions. Several considerations support these decisions. To begin with, Congress presumptively delegates administrative and interpretive power to the agency itself, and not to its counsel. *See Bowen*, 488 U.S. at 213. Moreover, the litigating positions asserted by low-level and partisan agency counsel are unlikely to reflect the views of the agency at all, much less its considered views. *See Smiley*, 517 U.S. at 741 ("The deliberateness of such positions, if not indeed their authoritativeness, is suspect."); Scalia, *Judicial Deference To Administrative Interpretations*

of Law, 1989 Duke L.J. 511, 519 ("there may be reason to doubt whether the position taken by a low-level agency litigator, or perhaps even by the general counsel, has the approval of the agency head"). Finally, deferring to the litigating position of a party agency would violate basic norms of impartial adjudication that the federal courts preserve and embody. *See, e.g.*, *Stutson v. United States*, 516 U.S. 163, 187 (1996) (Scalia, J., dissenting) (*Bowen* reflects "a decent concern for those litigating against the government"); Scalia, 1989 Duke L.J. at 519-20 ("Whatever else an agency's choice among the various interpretive options may be based upon, it should not be based upon the desire to win a particular lawsuit."); Anthony, *Which Agency Interpretations Should Bind Citizens And The Courts?*, 7 Yale J. Reg. 1, 60-61 (1990) ("Even the cynical should balk at assuming that Congress has delegated such a power to judge one's own cause."). Although *Bowen* on its facts involved a litigating position interpreting an ambiguous statute, these considerations are fully applicable to litigating positions interpreting ambiguous regulations.

Finally, although this Court has not addressed the question in detail, it has twice stated that *Seminole Rock* deference should not extend to agency litigating positions. In *Martin v. OSHRC*, the Court, in explaining the rationale for *Bowen*, stated that "[b]ecause statutory *and regulatory* interpretations furnished [in litigation] occur after agency proceedings have terminated, they do not constitute an exercise of the agency's delegated lawmaking powers." 499 U.S. at 156-57 (emphasis shifted). Similarly, in *Cottage Savings Association v. CIR*, 499 U.S. 554, 562-63 (1991), the Court explained that the question of what constitutes a "material difference" under 26 C.F.R. § 1.1001-1 "is not one on which we can defer to the Commissioner," precisely because "the Commissioner has not issued an authoritative, *prelitigation* interpretation of what property exchanges satisfy this requirement" (emphasis added).

2. These principles plainly apply to IRS litigating positions asserted in the United States Tax Court, which Congress constituted not as an executive or independent agency, but as an Article I "court of record" (26 U.S.C. § 7441). Accordingly, this Court has stressed its exclusively judicial nature: "The Tax Court exercises judicial, rather than executive, legislative, or administrative, power. It was established by Congress to interpret and apply the Internal Revenue Code in disputes between taxpayers and the Government." *Freytag v. CIR*, 501 U.S. 868, 890-91 (1991). Because its "function and role in the federal judicial scheme closely resemble those of the federal district courts" (*id.*), deference to agency litigating positions is equally inappropriate in the tax court as it would be in a district court.

The allocation of authority within the executive branch further undercuts the argument for extending *Seminole Rock* deference to agency litigating positions in tax cases. Congress delegated rulemaking and therefore interpretive authority to the Secretary of the Treasury (26 U.S.C. § 1502), who in turn has delegated that authority to the Commisioner of Internal Revenue (26 C.F.R. § 301.7805-1(a)) and to the Assistant Secretary for Tax Policy (*see* Coverdale, *Court Review of Tax Regulations and Revenue Rulings in the Chevron Era*, 64 Geo. Wash. L. Rev. 35, 51 (1995)). On the other hand, depending on the taxpayer's litigation strategy, the government's litigating positions might be asserted by an attorney in the Office of District Counsel for IRS (in tax court), by an attorney in the Department of Justice Tax Division (in district court), or by an attorney in the Department of Justice Court of Federal Claims Section. *See* N. Crimm, *supra*, ¶ 2.4[4][c], at 2-111. Given these diffuse rulemaking and litigation responsibilities, it is particularly

implausible that any of the latter staff attorneys can be presumed to speak for all of the former policymakers.[10]

3. Apart from its various other legal shortcomings, the decision below also threatens to eviscerate *Bowen* itself. Interpretive questions cannot be neatly categorized as either statutory or regulatory. Usually, the interpretation at issue addresses the putative scope of both the statute and its implementing regulations: for example, what constitutes "unpaid losses" under the Tax Code and its implementing regulations (*see Harco Holdings*, 977 F.2d at 1029-30 & n.5, 1034-36 & n.12); what constitutes "coal mine dust" under the Black Lung Benefits Act and its implementing regulations (*see William Bros.*, 833 F.2d at 264-65); or what constitutes a "default" under the Truth in Lending Act and its implementing regulations (*see Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555, 561 (1980)). Similarly, this case involves the related interpretive questions what constitutes impermissible offsetting "in determining the taxable income of a [life] member" under 26 U.S.C. § 1503(c)(2) (Pet. App. 18a-23a) and what constitutes "ineligible" losses that cannot "be set off against consolidated partial [life insurance company taxable income]" under 26 C.F.R. § 1.1502-47(m)(3)(vi) and (m)(4) (Pet. App. 15a-18a). Under *Bowen*, an agency litigating position addressed solely to the former question plainly would warrant no deference. Under the decision below, however, an agency litigating position addressed to *both* questions *does* warrant deference, because *Bowen* is held inapplicable to the

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[10] In the litigation below, the government insisted that the Assistant Secretary for Tax Policy has "exclusive authority to make final determinations of the Treasury's position" and that this official "expresses his Department's institutional views through formally promulgated rules and regulations." Brief of Appellee at 33, *Connecticut General Life Ins. Co. v. CIR*, No. 97-7612 (3d Cir. May 29, 1998). Those assertions simply underscore the inappropriateness of deferring to the litigating positions asserted by a staff attorney in a local IRS office.

latter question (Pet. App. 14a-15a), and because the former question is defined not as testing the litigating position against the statute, but as testing only the implementing regulation (as "interpreted" by the agency, Pet. App. 18a) against the statute. Put more bluntly, the court of appeals' decision permits any agency to exempt itself from *Bowen* simply by copying or paraphrasing its organic statute in any of its implementing regulations. That cannot be the law.

B. This Court Has Long Held That Ambiguous Tax Provisions Must Be Construed In Favor Of The Taxpayer

Recognizing that "the power to tax involves the power to destroy," *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 431 (1819), this Court has long applied special rules of construction in the taxation context. *See County of Yakima v. Confederated Tribes & Bands of the Yakima Indian Nation*, 502 U.S. 251, 258 (1992). One of those rules is that ambiguous tax provisions (whether statutes or regulations) must be construed in favor of the taxpayer.

In *Gould v. Gould*, 245 U.S. 151, 153 (1917), this Court unanimously adopted the principle that, "[i]n case of doubt," ambiguous tax provisions "are construed most strongly against the Government, and in favor of the citizen." Finding "obscurity" in the governing provision, the Court rejected the litigating position of the government, and held that the operative definition of "income" did not include the alimony payments at issue. *See id.* Similarly, in *Reinecke v. Northern Trust Co.*, 278 U.S. 339, 348 (1929), this Court, after finding it "doubtful" whether or not the governing provision encompassed the trusts at issue, rejected the litigating position of the government and held, citing *Gould*, that "[t]hat doubt must be resolved in favor of the taxpayer." Legions of cases have reaffirmed these principles. *See, e.g., Hassett v. Welch*, 303 U.S. 303, 314 (1938) ("if doubt exists as to the construction of a taxing statute, the doubt should be resolved

in favor of the taxpayer"); *White v. Aronson*, 302 U.S. 16, 20 (1937) ("Where there is a reasonable doubt as to the meaning of a taxing Act it should be construed most favorably to the taxpayer."); *Burnet v. Niagara Falls Brewing Co.*, 282 U.S. 648, 654 (1931) ("It is a familiar rule that tax laws are to be liberally construed in favor of taxpayers."); *United States v. Merriam*, 263 U.S. 179, 188 (1923) ("If the words [of a tax provision] are doubtful, the doubt must be resolved against the Government and in favor of the taxpayer.").

The court of appeals created an opposite interpretive presumption. It concluded that ambiguity in tax regulations must be resolved in favor of the *government*, through deference to its litigating positions. The court of appeals thus not only ignored, but in fact inverted, a fundamental rule of construction embraced by this Court for decades. On that ground alone, further review is warranted.

C. *Gardebring* Provides No Support For The Court Of Appeals' Holding

Against all of these administrative law and tax decisions, the court of appeals relied solely on this Court's decision in *Gardebring v. Jenkins*, 485 U.S. 415 (1988), which it construed as mandating deference to agency litigating positions interpreting ambiguous regulations. Pet. App. 15a. *Gardebring* does not remotely support that holding.

As an administrative law matter, *Gardebring* falls within a narrow exception to *Bowen* that is plainly inapplicable here. In *Gardebring*, the agency was not a *party* to the underlying litigation, but appeared only in this Court, only as an *amicus*, and only at this Court's request. *See* 485 U.S. at 416. Although *Gardebring* did not discuss the question of agency litigating positions in any detail, a subsequent case involving Supreme Court *amicus* briefs explained that, in that limited context, there is "no reason to suspect that the interpretation does not reflect the agency's fair and considered judgment on

the matter in question." *Auer v. Robbins*, 519 U.S. 452, 462 (1998). Like *Gardebring*, *Auer* involved the question whether an agency litigating position interpreting an ambiguous regulation is entitled to deference. *See id.* at 461-62. This Court distinguished *Bowen* not on the broad ground that *Bowen* is inapplicable to administrative interpretations of ambiguous regulations, as the court of appeals would have it, but only on the narrow ground that, "in the circumstances" of an invited Supreme Court *amicus* brief, the litigating position might plausibly reflect the "fair and considered judgment" of the agency itself. *See id.* at 462. That rationale is plainly inapplicable to the positions asserted by partisan counsel representing the IRS as a party in a trial court proceeding.

In any event, neither *Gardebring* nor *Auer* was a tax case: *Gardebring* involved construction of AFDC regulations by the Secretary of Health and Human Services (485 U.S. at 427-30), and *Auer* involved construction of FLSA regulations by the Secretary of Labor (519 U.S. at 461-63). Neither decision can even remotely be read as mandating deference to agency litigating positions in tax cases, and thus silently overruling the entire case line of *Gould* and its progeny.

III. IF NOT CORRECTED, THE DECISION BELOW WILL HAVE SWEEPING AND TROUBLING CONSEQUENCES

The breadth and significance of the decision below are difficult to overstate. By its terms, the court of appeals' holding applies to any interpretive dispute regarding any term that appears in the Code of Federal Regulations. The decision below thus controls a potentially limitless range of issues, including not only interpretations of the Tax Code by the IRS, but also, to name only a few possible examples, interpretations of Department of Defense regulations by the Navy, *see United States v. Larionoff*, 431 U.S. 864, 872 (1977); interpretations of the Sentencing Guidelines by the United States Sentencing Commission, *see Stinson v. United States*, 508 U.S. 36, 45

(1993); and interpretations of Medicare regulations by the Secretary of Health and Human Services, *see Shalala v. Guernsey Memorial Hosp.*, 514 U.S. 87, 94-95 (1995). Because there are far more regulations than statutes, *Seminole Rock* is at least as important as *Chevron*, *see* Manning, 96 Colum. L. Rev. at 696, which makes this case at least as important as *Bowen*.

The decision below also effectively decides all *Seminole Rock* questions about what informal *pre*-litigation interpretations are entitled to deference. This Court has not made clear the extent to which such informal interpretations are entitled to deference. *See, e.g., Metropolitan Stevedore Co. v. Rambo*, 521 U.S. 121, 138 n.9 (1995) (interpretation must be "embodied in [a] regulation or similarly binding policy statement" to warrant deference); *City of Chicago v. Environmental Defense Fund*, 511 U.S. 328, 339 n.5 (1994) (reserving question whether "agency interpretation expressed in a memorandum" is entitled to deference); *see generally* Anthony, *Interpretive Rules, Policy Statements, Guidances, Manuals and the Like — Should Federal Agencies Use Them To Bind The Public?*, 41 Duke L.J. 1311 (1992). The decision below, however, effectively moots any *Seminole Rock* question about informal pre-litigation interpretations because, even if no such interpretations exist, the agency litigating position is itself nonetheless entitled to deference.

The decision below also will exacerbate the problem of daunting complexity in the tax law. Late in his life, the leading tax lawyer of this century concluded that tax law had become "bewildering," Griswold, 11 ABA Sec. Tax'n Newsl. 56, 57 (1992), and even "monstrous," Griswold, *Is the Tax Law Gone To Seed*, 11 Am. J. Tax Pol'y 1, 9 (1994). Justice O'Connor has similarly expressed frustration with the "maze of regulations" promulgated by the IRS. *CIR v. Estate of Hubert*, 520 U.S. 93, 122 (1997) (opinion concurring in the

judgment).[11] This system has developed even though, under *Gould* and its progeny, the IRS properly bears the risk of any ambiguity in its own regulations. By inverting *Gould*, the court of appeals not only eliminated that modest structural check, but also created affirmative incentives for even more regulatory vagueness and complexity. As Justice Thomas has explained: "It is perfectly understandable . . . for an agency to issue vague regulations, because to do so maximizes agency power and allows the agency greater latitude to make law through adjudication rather than through the more cumbersome rulemaking process." *Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 525 (1994) (dissenting opinion).[12]

Finally, the decision below will undercut many of the protections that Congress has afforded to taxpayers. As explained above, Congress provided for the application of tax regulations to be determined through independent adjudication

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[11] Commentators have frequently noted this problem. *See, e.g.*, A. Dubroff *et al.*, *Federal Income Taxation of Corporations Filing Consolidated Returns* § 2.02, at 2.7 (2d ed. 1999) (tax regulations "have resulted in complexity that is often unworkable for all but the most sophisticated taxpayer"); Dembitzer, *Beyond the IRS Restructuring and Reform Act of 1998: Perceived Abuses of the Treasury Department's Rulemaking Authority*, 52 Tax. Law. 501, 518 (1999) ("It is beyond cavil that many provisions in Treasury Regulations are complicated and difficult to decipher."); Schwidetzky, *Hyperlexis and the Loophole*, 49 Okla. L. Rev. 403, 404 (1996) ("Tax law is, of course, a case of hyperlexis run extraordinarily amok."). The life-nonlife consolidation regulations, which can fairly be characterized as impenetrable provide ample support for that criticism. *See* Pet. App. 42a-71a.

[12] Recently, the IRS has adopted the tactic of issuing so-called "anti-avoidance" or "anti-abuse" regulations, which impose liability on transactions that comply with all applicable laws, but are designed to "avoid the purposes of underlying regulations." Dubroff, *supra* note 11, § 2.01, at 2-1; *see also* Olson, *Some Thoughts on Anti-Abuse Rules*, 48 Tax Law. 816 (1995). If courts defer to litigating positions interpreting these regulations, then the IRS's enforcement powers will be virtually unbounded.

by courts constituted outside the executive branch. *See Freytag*, 501 U.S. at 890-91. Moreover, in the consolidated return context in particular, Congress specifically required tax regulations to be "clea[r]" (26 U.S.C. § 1502) and to be promulgated "prior to" the due date for the returns at issue (*id.* § 1503(a)). Despite these principles, the court of appeals upheld a $200 million tax liability (including primarily accrued interest), based on an interpretation asserted by partisan agency counsel in litigation conducted seven years after the tax years in question, and on a bare judicial determination that counsel's position was not entirely "unreasonable." The patent unfairness of that decision, and its inconsistency with the controlling principles of tax and administrative law, could not be more self-evident.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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Dated: August 12, 1999

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Connecticut General Life Insurance Company,
Appellant,
v.
Commissioner of Internal Revenue
(Tax Court No. 92-21212).

CIGNA Corporation And Consolidated
Subsidiaries, Appellants,
v.
Commissioner of Internal Revenue
(Tax Court No. 92-21213).

Nos. 97-7612, 97-7619.

Decided April 30, 1999.

OPINION OF THE COURT

SLOVITER, Circuit Judge.

Connecticut General Life Insurance Company, appellant in No. 97-7612, and CIGNA Corporation and Consolidated Subsidiaries ("the CIGNA Group"), appellants in No. 97-7619, appeal from the judgment of the United States Tax Court upholding notices of deficiency issued against them by the Commissioner of Internal Revenue in the amount of $62,176,665. For convenience, we will refer to the appellants collectively as "CIGNA." CIGNA complains that the Tax Court improperly deferred to the Commissioner's restrictive interpretation of the section of the Internal Revenue Code that limits the ability of affiliated insurance companies to file consolidated federal income tax returns. Because we conclude that the applicable Treasury regulation, as interpreted by the

Commissioner, is a permissible interpretation of the statute, we will affirm.

I. BACKGROUND

Traditionally, life insurance companies ("life companies") have been profitable, whereas companies writing property or casualty insurance (P & C) have often been unprofitable. Nonlife insurance companies ("nonlife companies") have long been permitted to file consolidated federal income tax returns with their affiliated nonlife companies, but not with their affiliated life insurance companies. Life companies were required to file separate returns or returns consolidated with other affiliated life companies.

The restrictions on life-nonlife consolidation were loosened when Congress enacted the Tax Reform Act of 1976. Pub. L. No. 94-455, 90 Stat. 1520. That Act modifies the Internal Revenue Code to permit life companies to file consolidated returns with nonlife companies, subject to certain exceptions (the "life-nonlife consolidation provisions"), for all taxable years beginning after December 31, 1980. *See* 26 U.S.C. §§ 1501, 1503-1504. At issue in this case is the interpretation of one of these statutory provisions, specifically the provision that limits certain setoffs between affiliated insurance companies filing consolidated returns.

A. The Statute

Section 1501 grants affiliated groups the privilege of making consolidated returns with their affiliated companies. If the affiliated group contains both life and nonlife members, § 1504 requires that a company belong to the group for at least five years before it is treated as affiliated therewith. Section 1503 then limits the extent to which losses incurred by nonlife members may be set off against gains realized by life members. Subsection (c)(1), in particular, caps the amount of nonlife setoff at a percentage of either nonlife loss or life income, whichever is less. It states:

> (1) In general — If . . . the consolidated taxable income of the [nonlife members] results in a consolidated net operating loss for such taxable year, then . . . the amount of such loss which cannot be absorbed in the applicable carryback periods against the taxable income of such [nonlife members] shall be taken into account in determining the consolidated taxable income of the affiliated group for such taxable year to the extent of 35 percent [30 percent in 1982] of such loss or 35 [30 percent in 1982] percent of the taxable income of the [life members], whichever is less.

26 U.S.C. § 1503(c)(1).

Subsection 1503(c)(2), the provision at issue here, further limits a group's ability to set nonlife losses off against life profits, providing: "Notwithstanding the provisions of paragraph [1503(c)(1)], a net operating loss for a taxable year of a [nonlife member of the group] *shall not be taken into account in determining the taxable income of a* [life member of the group] . . . if such taxable year precedes the sixth taxable year such members have been members of the same affiliated group . . . ." (emphasis added). Resolution of the instant dispute requires us to determine the scope of this latter limitation.

B. The Acquisitions

The facts of this case are not in dispute. *See* First Stipulation of Facts, App. at 71-88; Second Stipulation of Facts, App. at 89-104. On March 30, 1982, Connecticut General Corporation (Connecticut General), was the common parent of more than forty affiliated subsidiaries (the CG Group), one of which was a life company, Connecticut General Life Insurance Company (CGL). The CG Group met the definition of an affiliated group under § 1504 and had filed a consolidated tax return following the Code revision. Thereby, the CG Group was able to offset some of CGL's income with a portion of the CG Group's nonlife loss. App. at 75-76.

At that time, INA Corporation (INA) was parent to over 160 affiliated nonlife subsidiaries (the INA Group), which subsidiaries met the requirements of § 1504 and filed consolidated returns under § 1501. The INA Group's strength was in property and casualty insurance, while the CG Group's strength was in the areas of life, health and annuity, and personal and commercial property insurance. App. at 75-78.

The following day, March 31, 1982, Connecticut General and INA (the two parent companies) merged to form a new company, CIGNA Corporation (CIGNA Corp.). The merger was a "reverse acquisition" within the meaning of 26 C.F.R. § 1.1502-75(d)(3), pursuant to which CIGNA Corp. succeeded Connecticut General as the common parent of the CG Group, which continued to exist for tax purposes. CIGNA Corp. also became the common parent of each of the former members of the INA Group, which group ceased to exist for tax purposes. App. at 73-74. Thus, in effect, the CG Group, which became the CIGNA Group, acquired the former INA subsidiaries individually.

Subsequently, on November 20, 1984, a subsidiary of CIGNA Corp. acquired Preferred Health Care, Inc. (PHC). Like INA and Connecticut General before the merger, PHC was itself common parent to a group of affiliated corporations (the PHC Group) (all nonlife companies), which qualified under § 1504 and filed consolidated returns under § 1501. All members of the PHC Group became members of the CIGNA Group upon acquisition and the PHC Group itself ceased to exist. App. at 75, 79-80.

C. The Promulgation of Regulations

On June 8, 1982, approximately two months after the Connecticut General/INA merger, the Commissioner, pursuant to 26 U.S.C. § 1502, promulgated proposed rules relating to the filing of life-nonlife consolidated returns. *See* Filing of Life-Nonlife Consolidated Returns, 47 Fed. Reg. 24,737

(1982). The proposed regulations adopted a subgroup method for computing a life-nonlife group's consolidated taxable income. In effect, they treated the members of the group as two separate subgroups, with the life members as one subgroup and the nonlife members as another. Each subgroup was required to set off the gains and losses of members within that subgroup to determine whether the subgroup incurred a consolidated net operating loss (CNOL) or a gain. Only after the gains from within the nonlife subgroup were set off by losses from within that subgroup could such losses be used to reduce the life subgroup's income.

The regulations further limited the portion of a nonlife subgroup's consolidated net operating loss (nonlife CNOL) that could be set off (up to the statutorily prescribed percentage) against net operating gains generated by the life subgroup: "The offsetable nonlife consolidated net operating loss that arises in any consolidated return year . . . is the [nonlife CNOL] *reduced by the amount of the separate net operating loss . . . of any nonlife member that is ineligible in that year*." *Id.* at 24,748 (to be codified at 26 C.F.R. § 1.1502-47(m)(3)(vi)(A)) (emphasis added). The proposed rules thus distinguished between "eligible" companies — those that had been members of the group for at least five years — and "ineligible" companies — those that had not been members for at least five years.

CIGNA wrote to the Commissioner on February 28, 1983, suggesting that proposed regulation § 1.1502-47(m)(3)(vi)(A) not be adopted with respect to acquired groups. CIGNA suggested instead that "separate nonlife members be treated as one entity if they are acquired in a single transaction by one group but were members of a different group prior to their acquisition." Letter from Kenneth W. Gideon, Chief Counsel, IRS, to Judith Soltz, Senior Counsel, CIGNA Corp. 1 (March 22, 1983), App. at 197. Under CIGNA's suggested approach, the losses of one ineligible acquired member would be used to

offset the income of other ineligible acquired members, before the losses of eligible members were used for that purpose. The effect would be to increase the amount of eligible nonlife loss remaining after all nonlife gains had been offset, and thus to increase the nonlife offset the group could claim against life income.

Final regulations had to be issued by March 14, 1983 to be effective for the 1982 taxable year. App. at 197; *see also* 26 U.S.C. § 1503(a). The Commissioner did not adopt CIGNA's suggestion before issuing these regulations, but after the final regulations were issued, Kenneth W. Gideon, Chief Counsel to the IRS, sent CIGNA a letter, stating: "[The] final life-nonlife consolidated return regulations . . . do not adopt your suggestion but the preamble to the final regulation indicates that it will be given further study." App. at 197. Gideon also noted that "a lack of time [had] prevented a complete and thoughtful analysis of [CIGNA's] proposed solution." App. at 197- 98.

The final regulations and preamble did differ from the proposed regulations in three respects: (1) a new § 1.1502-47(m)(4) was added, which states in its entirety, "Acquired groups. [Reserved]"; (2) § 1.1502-47(m)(3)(vi)(A) was amended to note that its definition of ineligible NOL applies only "for purposes of . . . subparagraph (3)"; and (3) the preamble was amended to state:

> [T]he Treasury Department will study further whether it is appropriate to aggregate the income and losses of ineligible members in certain cases. For instance, notwithstanding the ordinary reading of section 1503(c)(2), it may be consistent with the intent of section 1503(c)(2), or correct as a matter of policy, to aggregate the income and losses of ineligible members that filed a consolidated return prior to their acquisition by (and includibility in) another group that files a consolidated return.

Filing of Life-Nonlife Consolidated Returns, 48 Fed. Reg. 11,436, 11,447-48, 11,440 (1983).

D. CIGNA's Consolidated Returns

In 1981, as soon as the Tax Reform Act of 1976 became effective, Connecticut General elected to take advantage of the opportunity the Act presented and treated CGL, its sole life insurance company affiliate, as an includible member of the CG Group, thereby setting off a portion of the CG Group's nonlife losses against CGL's income. For the years ending December 31, 1982 (which was after the INA acquisition) through December 31, 1985, CIGNA continued to file life-nonlife consolidated income tax returns. CGL, the only life company involved, had income throughout this period. The nonlife companies, which included, *inter alia*, those companies that were former members of the INA Group (for the 1982-85 returns) and the former members of the PHC Group (for the 1984-85 returns), had both income and loss. App. at 76, 80-81.

CIGNA computed its taxable income as follows:

1. It consolidated (netted out) the income and losses of all nonlife companies to arrive at the consolidated net operating loss or income.

2. It consolidated (netted out) the losses (all ineligible) and income of the former INA group members to calculate the net operating loss attributable to those companies as a group.

3. It consolidated (netted out) the losses (all ineligible) and income of the former PHC group members to calculate the net operating loss attributable to those companies as a group.

4. It aggregated the operating losses of other non life companies acquired within less than five years of the return (and hence ineligible).

5. It added 2, 3, and 4 above to calculate the ineligible net operating loss.

6. It subtracted the ineligible net operating loss from 1 above to calculate the eligible net operating loss.

App. at 85-86.

This treatment of the individual member companies of a former group as if they were a single company has been called the single entity method. Under CIGNA's approach, the losses of the former group members were reduced by the income of the members of that group, and that reduced loss was the figure treated as ineligible and deducted from the consolidated net operating loss of all the members of the CIGNA Group.

As calculated by CIGNA, the acquisition of the INA Group had no effect on its tax liability, and the overall taxable income of the CIGNA Group (including the INA and PHC Groups) in the years 1982 through 1985 was equal to the sum of what would have been these three groups' separate taxable incomes had the groups not combined. *See* Appellants' Br. at 12, 20.

E. The Commissioner's Audit

On June 23, 1992, the Commissioner of Internal Revenue issued notices of deficiency to CGL for its taxable year ending December 31, 1980, and to CIGNA Group for its taxable years ending December 31, 1982 through December 31, 1985. App. at 28-31, 45-53.

Following the mode of analysis set forth in 26 C.F.R. § 1.1502-47(m)(3)(vi)(A), the Commissioner calculated CIGNA's ineligible loss in the following manner:

1. The income and losses of all nonlife companies were consolidated (netted out) to arrive at the consolidated net operating loss or income.

2. The losses of each of the companies acquired within less than five years of the return were aggregated to calculate the ineligible net operating loss.

3. The ineligible net operating loss was subtracted from the figure arrived at after the calculation in 1 above to calculate the eligible net operating loss.

App. at 87.

The Commissioner thus applied the separate entity method under which each of the former members of the INA and PHC Groups (all nonlife companies) was treated as a separate entity whose loss, if any, was subtracted from the consolidated net operating loss because the member was affiliated less than five years. Because each acquired company is treated as a separate entity, the fact that it was part of a group acquisition or that the group, prior to being acquired, had previously filed a consolidated return is not taken into account or relevant to its tax treatment after the acquisition.

The contrasting methods made a substantial difference in the amount of net operating loss of the nonlife companies that could be taken into account in determining CIGNA's taxable income for 1982 through 1988. The following shows the result of the Commissioner's approach and that used by CIGNA in filing its returns with respect to the nonlife net operating loss eligible to reduce CGL's taxable income.

Eligible Nonlife Net Operating Loss

Year	CIGNA Calculation	Commissioner Calculation
1982	($34,888,309)	($10,225,979)
1983	($28,810,677)	($8,351,216)
1984	($116,008,516)	($26,734,260)
1985	($ 96,060,581)	($94,424,416)

(These numbers are undisputed and reflect the appropriate 30% or 35% limitation set forth in § 1503(c)(1)).

Thus, under the Commissioner's approach, because of the reduction in the eligible nonlife net operating loss, the CIGNA Group had $136,032,212 more consolidated taxable income than under CIGNA's approach. App. at 42, 54. The Commissioner assessed the following deficiencies accordingly:

Petitioner	*Year*	*Deficiency*
CGL	1980	$ 3,360,873[1]
CIGNA Group	1982	$15,080,878
CIGNA Group	1983	$ 1,916,121
CIGNA Group	1984	$41,066,157
CIGNA Group	1985	$ 752,636

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[1] The deficiency determined against CGL flows indirectly from the Commissioner's disallowance of a portion of the nonlife loss setoffs the CIGNA Group claimed on its returns. Resolution of CIGNA's claim regarding these setoffs will determine what, if any, deficiency is properly assessed against CGL. App. at 72-73.

Total Tax Deficiency (exclusive of interest and penalties): $62,176,665[2]

On September 21, 1992, the CIGNA Group and CGL petitioned the Tax Court for a redetermination of the deficiencies set forth in the Commissioner's Notices of Deficiency. App. at 23-31, 38-53. The cases were subsequently consolidated. On February 23, 1996 and February 26, 1996, respectively, the Commissioner and CIGNA filed motions for summary judgment before the Tax Court. App. at 57-66. That court found in favor of the Commissioner. *Connecticut Gen. Life Ins. Co. v. Commissioner*, 109 T.C. 100 (1997). The CIGNA Group and CGL each filed a Notice of Appeal on November 21, 1997. App. at 2, 5.

The sole issue before the Tax Court was the proper calculation of the offsetable consolidated net operating loss of recently acquired nonlife companies (INA and PHC) when the group by which they were acquired (ultimately CIGNA) files a life-nonlife consolidated return under the auspices of § 1503(c)(1) and (2). The Tax Court found that "under [CIGNA's] single entity method losses of the ineligible nonlife companies of the former INA and PHC Groups were, in effect, indirectly made available to reduce income of [CGL], the life company." *Connecticut Gen. Life Ins. Co.*, 109 T.C. at 104. Because it also found the Commissioner's interpretation of the legislative regulations to be "sufficiently consistent with section 1503(c)(2) and its legislative purpose" to merit *Chevron* deference, *see Chevron, U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984), the court upheld the notices of deficiency. Connecticut Gen. Life Ins. Co., 109 T.C. at 111-12. The Tax Court had jurisdiction under 26 U.S.C. §§ 6213(a), 6214(a) and 7442. We have jurisdiction to review

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[2] In CIGNA's appellate brief, it reported that interest on the deficiency was more than $150 million at that time. Appellants' Br. at 3.

that court's grant of summary judgment under 26 U.S.C. § 7482. Our review is plenary. *See Lerman v. Commissioner*, 939 F.2d 44, 46 (3d Cir. 1991).

II. DISCUSSION

CIGNA contends that it was error for the Tax Court to uphold the deficiency assessments because the method CIGNA used in calculating its tax liability complied with all applicable laws and regulations. CIGNA's primary argument is that because none of the regulations adopted by the Commissioner in 1983 explicitly covers a group acquisition, it was free to follow any reasonable method to calculate the net operating loss of the members of the acquired INA and PHC Groups. *See Gottesman & Co. v. Commissioner*, 77 T.C. 1149 (1981) (holding that, after Commissioner proposed two conflicting regulations but adopted neither, leaving no regulation in place, the taxpayer's choice of one of the proposals was reasonable and would be sustained). It disagrees with the Commissioner's position that 26 C.F.R. § 1.1502-47(m)(3)(vi)(A) applies to acquired groups of nonlife companies, and it argues that the regulation is limited to acquisition of stand alone companies. As an alternative, CIGNA argues that if Regulation -47(m)(3)(vi)(A) is interpreted to govern the group acquisitions at issue, then that regulation is arbitrary, capricious, and therefore unenforceable.

When Congress enacted the Internal Revenue Code revisions on consolidated returns, it gave the Secretary of the Treasury broad authority to promulgate necessary regulations with respect thereto. *See* 26 U.S.C. § 1502. Pursuant to this authority, the Secretary promulgated the regulations at issue here, which are deemed legislative in character. *See Tate & Lyle, Inc. v. Commissioner*, 87 F.3d 99, 104 (3d Cir. 1996).

Ordinarily, our review of an agency's construction of the statute it has been charged with executing is deferential. In

Sekula v. FDIC, 39 F.3d 448 (3d Cir. 1994), we summarized our standard of review as follows:

> When reviewing an agency's construction of a statute, if the intent of Congress is clear, then we must give effect to that intent. If the statute is silent or ambiguous with respect to a specific issue, then a deference standard applies, and the question for the court becomes whether the agency's answer is based on a reasonable construction of the statute. In determining whether an agency's regulation complies with its congressional mandate, we look to see whether the regulation harmonizes with the plain language of the statute, its origin, and its purpose. So long as the regulation bears a fair relationship to the language of the statute, reflects the views of those who sought its enactment, and matches the purpose they articulated, it will merit deference.

Id. at 451-52 (citations omitted).

To merit deference, an agency's interpretation of the statute must be supported by "regulations, rulings, or administrative practice." *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 212 (1988). We will not defer to "an agency counsel's interpretation of a statute where the agency itself has articulated no position on the question." *Id.*

Once an agency has adopted regulations interpreting the statute, the agency's consistent interpretation of its own regulation will also be accorded substantial deference. We "must defer to the [agency's] interpretation unless an 'alternative reading is compelled by the regulation's plain language or by other indications of the [agency's] intent at the time of the regulation's promulgation.'" *Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 512 (1994) (quoting *Gardebring v. Jenkins*, 485 U.S. 415, 430 (1988)); accord *Shell Oil Co. v. Babbitt*, 125 F.3d 172, 176 (3d Cir. 1997).

Nonetheless, "[t]he responsibility to promulgate clear and unambiguous standards is upon the Secretary." *Director, Office*

of Workers' Compensation Programs, U.S. Dept. of Labor v. Eastern Associated Coal Corp., 54 F.3d 141, 147 (3d Cir. 1995) (internal quotation marks omitted). Thus our deference to an agency's interpretation of its own regulations is "tempered by our duty to independently insure that the agency's interpretation comports with the language it has adopted." *Director, Office of Workers' Compensation Programs, U.S. Dept. Of Labor v. Gardner*, 882 F.2d 67, 70 (3d Cir. 1989).

A. Whether an Applicable Regulation Has Been Adopted

In order for CIGNA to prevail on its primary argument, it must convince us that no regulation governs the manner in which consolidated net operating loss of acquired groups must be treated. At the outset, CIGNA faces a major hurdle because the Commissioner concededly did promulgate a regulation, -47(m)(3), which deals with the treatment of acquired nonlife members. CIGNA concedes that Regulation -47(m)(3) governs the treatment of acquired stand-alone nonlife members, but it argues that it does not cover the treatment of "*acquired groups*" of nonlife members. As to those, CIGNA asserts, there was no regulation promulgated by the Commissioner, who instead reserved that question for another day under Regulation -47(m)(4).

The Internal Revenue Service (IRS) interprets these regulations differently. It insists that Regulation -47(m)(3) applies to all ineligible nonlife companies, whether they are acquired individually or as part of a group. It interprets Regulation -47(m)(4) as doing no more than reserving a place in the *Code of Federal Regulations* for the Commissioner to insert a regulation requiring different treatment of acquired groups should the Commissioner later determine that such different treatment is appropriate.

CIGNA argues that, under *Bowen*, 488 U.S. at 212, the interpretation the Commissioner advances in this case is not

entitled to deference because it is a "mere" litigating position. CIGNA's reliance on *Bowen* is misplaced. *Bowen*, which concerned the amount of deference due an administrative agency's informal interpretation of a statute, does not address what deference we should accord an agency's interpretation of its own regulations, such as is at issue here. Indeed, the Supreme Court has deferred to an agency's interpretation of its own regulations, even when that interpretation was proffered for the first time in litigation, *see Gardebring v. Jenkins*, 485 U.S. 415, 430 (1988), as have we, *see Elizabeth Blackwell Health Ctr. for Women v. Knoll*, 61 F.3d 170, 183 & n. 9 (3d Cir. 1995).

Thus, we will defer to the IRS's interpretation unless that "alternative reading is compelled by the regulation's plain language or by other indications of the [agency's] intent at the time of the regulation's promulgation." *Gardebring*, 485 U.S. at 430.

1. The Text of -47(m)(4)

CIGNA insists that unless subsection 26 C.F.R. § 1.1502-47(m)(3)(vi) applies only to the acquisition of individual companies, the heading "Acquired groups" on -47(m)(4) would be without significance. CIGNA emphasizes the designation of "[Reserved]" on that regulation and points to various definitions which equate the terms "reserved" and "reserve" with notions of setting aside or apart and of deferring a determination. CIGNA then further claims that this interpretation of "reserved" accords with both the Commissioner's past administrative practice and the understanding of former high-ranking treasury officials.

We are not convinced. We agree that use of the term "reserved" implies that something has been set aside. CIGNA, however, assumes that what was set aside was "the subject matter of the regulation" and further that the subject matter of the regulation was "the treatment of the loss of nonlife

members acquired as a group." Appellant's Br. at 24. It is equally likely that what was set aside was the numerical subsection -47(m)(4) and the space in the regulation it demarcates.

CIGNA further attempts to establish that the "Commissioner's customary administrative practice [was to] interpret[ ] 'reserved' in a regulation as a signal that there is no regulatory rule to govern the referenced subject matter" by identifying some instances in which the Commissioner used that term to have that meaning. Appellant's Br. at 24. That is not conclusive. In fact, the Office of the Federal Register, *Document Drafting Handbook* (1991), suggests a different use for the term "reserved." It describes "reserved" as "a term used to maintain the continuity of codification in the CFR" or "to indicate where future text will be added." *Id.* at 27. We find nothing in the precedent that CIGNA cites to preclude the Commissioner from using the term "reserved" in accordance with the *Document Drafting Handbook*, rather than to connote the absence of a substantive rule.

Finally, we accord little weight to the 1996 recollections of the several Treasury officials who submitted affidavits regarding the meaning of the reserved clause for acquired groups. In the first place, the affidavits are inconsistent: William McKee states that "reserved" means that no regulation addresses the treatment of the reserved issue, App. at 226, but Andrew D. Pike understood that the general rule would continue to apply until a special rule was created for acquired groups, App. at 229. Moreover, reliance upon remembered details from officials who lacked the ultimate authority to issue any proposed regulation has little support in the law. *See Armco, Inc. v. Commissioner*, 87 T.C. 865, 867 (1986) ("[N]o one's personal views can be accepted as a pronouncement of the intended meaning of the regulation."); *cf. Western Air Lines, Inc. v. Board of Equalization*, 480 U.S. 123, 131 n. * (1987) ("[The] attempt at the creation of legislative history

through the *post hoc* statements of interested onlookers is entitled to no weight. . . .").

In sum, we, like the Tax Court, conclude that nothing in Regulation -47(m)(4) contradicts the Commissioner's interpretation of Regulation -47(m)(3)(vi) as applying to acquired groups. At most, Regulation -47(m)(4) is a "neutral factor." *Connecticut Gen. Life Ins. Co.*, 109 T.C. at 109.

2. The Preamble

CIGNA next contends that the preamble supports its view that there is no rule governing the acquisition of groups. We have stated that "the preamble to a regulation may be used as an aid in determining the meaning of a regulation." *Commonwealth of Pennsylvania v. United States Dept. of HHS*, 101 F.3d 939, 944 n.4 (3d Cir. 1996). Here, the Preamble states, "[T]he Treasury Department will study further whether it is appropriate to aggregate the income and losses of ineligible members in certain cases. For instance, notwithstanding the ordinary reading of § 1503(c)(2), it may be consistent with the intent of § 1503(c)(2), or correct as a matter of policy, to aggregate the income and losses of ineligible members that filed a consolidated return prior to their acquisition by (and includibility in) another group that files a consolidated return." Filing of Life-Nonlife Consolidated Returns, 48 Fed. Reg. at 11,440.

This passage does not contradict the IRS's interpretation of Regulation -47(m)(3)(vi) as applying to acquired groups. Indeed, it suggests that applying a rule other than that annunciated in -47(m)(3)(vi) would contradict "the ordinary reading of section 1503(c)(2)." The passage does suggest that it might be justifiable, nonetheless, to have such a rule, and it indicates that officials within the Treasury would consider adopting a different rule for acquired groups. Significantly, no such special rule was ever adopted. Under these circumstances, there is nothing unreasonable about the

Commissioner's enforcement of the rule that did exist, a rule that, by its own terms, applies to these facts.

Because the interpretation advanced by the IRS is neither inconsistent with any prior interpretation of these regulations nor incompatible with their plain text, we defer to that interpretation. We thus regard -47(m)(3) as applicable to acquired groups.

B. Whether the Regulation is Arbitrary, Capricious, and Unreasonable

CIGNA's alternative argument is that the regulation, which is interpreted by the Commissioner to be applicable to treatment of acquired groups, is not entitled to deference because it is arbitrary, capricious, and unreasonable. CIGNA concedes that we must defer to a regulation that is a reasonable implementation of the congressional mandate, but it argues that a regulation is only a reasonable statutory interpretation if it "'harmonizes with the statute's plain language, origin, and purpose.'" Appellants' Br. at 31-32 (citing *National Muffler Dealers Ass'n v. United States*, 440 U.S. 472, 477 (1979)). Thus, we must review the legislative history of the Tax Reform Act of 1976 with an eye toward discerning the origin and purpose of the revision allowing life-nonlife consolidated tax returns.

In the debates before Congress, it was suggested that lifting the ban on life-nonlife consolidated returns would help alleviate the acute shortage of insurance writing capacity in the property and casualty industry. *See, e.g.*, 122 Cong. Rec. 24,683 (statement of Sen. Ribicoff), 24,687 (statement of Sen. Curtis); S. Rep. No. 94-938, at 456, *reprinted in* 1976 U.S.C.C.A.N. 3439, 3882. The Senate Report noted that P & C companies affiliated with other nonlife companies had long been permitted to file consolidated returns whereas P & C companies that happened to be affiliated with life companies had not been able to do so. *See* S. Rep. No. 94-938, at 454, *reprinted in* 1976

U.S.C.C.A.N. at 3881. The Report states: "[T]he present ban on life-nonlife consolidations has been a hardship for casualty companies which are affiliated with life companies," and explains that "[t]he committee amendment deals with this problem." *Id.*

At the same time, the legislators recognized that the then-existing ban on consolidated returns had assured that life insurance companies paid tax at the regular rate on an amount approximately equal to their taxable investment income. They sought to retain that result in drafting the new life-nonlife provisions, presumably by limiting the permissible offset to a percentage of life income incorporated in § 1503(c)(1). *See id.*; Staff of the Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976 (H.R. 10612, 94th Congress, Public Law 94-455)* at 435-36 (1976) ("[C]ongress adopted a provision which preserves the concept that some tax be paid with respect to the life insurance company's investment income . . . but which at the same time provides substantial relief in the future for casualty companies with losses.").[3]

Shortly before the bill was enacted, the Conference Committee added § 1503(c)(2), the section at the center of the CIGNA-IRS dispute. That section provides that the net operating loss of a member of the group of affiliated companies "shall not be taken into account" unless that member has been a member of that group for five years. The Conference Report does not suggest a reason for this amendment. The slim legislative history reveals merely that, during the hearings relating to the life-nonlife consolidation provisions, Senator Kennedy in particular had expressed some concern that the

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[3] The Senate Report estimated that these provisions would "result in a decrease in revenues of $25 million in the fiscal year 1978, $55 million in the fiscal year 1979, $49 million in the fiscal year 1980, and $40 million in the fiscal year 1981." S. Rep. No. 94-938, at 457, *reprinted in* 1976 U.S.C.C.A.N. at 3884.

largest life insurance companies might seek to enlarge the tax benefit provided by the new provisions by acquiring small loss-ridden P & C companies for the purposes of generating nonlife losses and setting these losses off against their taxable income. *See id.* at 24,685 ("Those [life insurance companies] who have substantial profits can go out and purchase other companies with tax losses in order to be able to write these losses off."). Section 1503(c)(2), as enacted, thus appears to have been designed to discourage tax-motivated acquisitions by insurance companies.

CIGNA argues that the Commissioner's approach runs counter to the origins and purposes of the Tax Reform Act of 1976 "because it exacerbates the very problem that Congress sought to address by enacting the life-nonlife consolidation provisions." Appellants' Br. at 31. CIGNA notes that although, collectively, the former INA Group members suffered net losses in each of the four years following their acquisition, under the Commissioner's calculation the combined group's taxable income increased by $136 million and its tax liability increased by approximately $60 million over the same four-year period, thereby reducing the group's capacity to write insurance. CIGNA characterizes the Commissioner's interpretation of Regulation -47(m)(3)(vi) as thus "penaliz[ing] the P & C industry contrary to the purpose of the life-nonlife consolidation provisions." Appellants' Br. at 33.

CIGNA's assessment of the congressional purpose is overly narrow. Congress did have an interest in increasing the capacity of the industry to write P & C insurance, which it effected through § 1501, which enables P & C companies to offset (partially) their losses against the income of their life affiliates by filing consolidated returns. Nothing in the regulations promulgated by the Commissioner prevented the former CG Group from taking full advantage of this opportunity by filing a consolidated tax return for its affiliated

companies and offsetting the P & C losses against life income, which it did beginning in 1981.

But, Congress apparently also had another subsidiary goal — to limit tax-induced shopping for acquisitions. And when the former CG Group chose, within a year of the statute's effective date, to affiliate with the INA Group to form CIGNA, it ran into § 1503, the section Congress enacted to effectuate that subsidiary goal. Although CIGNA could continue to have the advantage of offsetting P & C losses within its historic group after the acquisition, it could not take advantage in any way of the losses of the INA Group. And CIGNA's protests notwithstanding, that is precisely what it seeks to do.

If none of the INA companies had income, § 1503 would be irrelevant, as the methods proffered by both CIGNA and the Commissioner would arrive at the same result; the same is true if all of the INA companies had income, as their income would be added to the income of the other affiliated companies. However, CIGNA proposes to permit the INA companies to offset income within the group by losses within the group before that income is added to that of the other now affiliated companies. In terms that may be too simplistic for the hundreds of millions of dollars at issue, this reduces the amount of income that could be added to the total CIGNA income. As the Commissioner explains, the net operating loss of a company that has not been a member of the group for five years is thus being "taken into account" by reducing the total income.

Perhaps recognizing that § 1503 serves a goal other than that of increasing P & C capacity, CIGNA describes the purpose of that section narrowly: "Section 1503(c)(2) had a narrow[ ], targeted purpose, and was intended only to address the specific concern that life companies might have a tax incentive to acquire nonlife companies to take advantage of additional future loss offset benefits." Appellants' Br. at 36. CIGNA insists that § 1503(c)(2) "was intended only to limit the *incremental* consolidation benefit that might be derived from

the acquisition of additional nonlife companies." *Id.* It then argues that the Commissioner's approach contradicts the statute by denying CIGNA more than this incremental benefit.

CIGNA points to nothing in the scant legislative history of this provision that compels such a narrow reading of § 1503(c)(2)'s purpose. Moreover, the statute contains no language that limits its effect to the denial of the incremental consolidation benefit. It says nothing more than that losses of companies that affiliated with the group less than five years ago shall not be taken into account.

CIGNA's argument that the Commissioner has interpreted § 1503(c)(2) too broadly focuses too narrowly on the short-term. Section 1503 only limits offsets for five years following an acquisition. After that time, group insurance companies such as CIGNA can offset the losses of acquired companies as permitted, thereby effecting an increase in P & C capacity. There is no indication that Congress focused, in the final stages of enactment of the Tax Reform Act of 1976, on the situation of group companies acquiring group companies. Even if it had, there is even less reason to think that it would have been swayed by the potential short-term disadvantage to some companies. More likely is that Congress was interested in the long-run solution. After all, it was Congress that imposed the five-year limitation in the first place.

Finally, CIGNA makes a policy argument that the INA companies should be permitted to offset losses against income because they had been permitted to do so before the acquisition. It contends that the Commissioner's regulation, as interpreted, is unfair because it requires that the income of profitable members of the acquired group be taken into account, but not the loss of acquired members. The simple answer, obviously unsatisfactory to CIGNA, is that the Commissioner, who has the delegated authority to promulgate legislative regulations, did not provide for initial offsets within the group. And there is no language in the statute that requires

the offset CIGNA seeks. In fact, there was disagreement within the IRS as to whether the Commissioner could have provided for such initial offsets without contradicting the statute. Before us, the IRS continues to characterize that question as arguable. Inasmuch as the Commissioner did not adopt CIGNA's approach, the issue is not before us and we make no comment.

We do note, however, that if CIGNA's approach were adopted, it would create a distinction between nonlife companies acquired as a group and those very same companies acquired individually that is hard to justify. Had CIGNA acquired only INA's profitable nonlife companies in 1981, there is no question that the acquisition would have increased its overall taxable income. And, as CIGNA presumably concedes, had CIGNA subsequently acquired the remainder of the INA Group, § 1503(c)(2) would have precluded offsetting that increase in taxable income with the losses of the later-acquired members. CIGNA has offered no justification for requiring the Commissioner to treat the instant case differently, merely because both acquisitions occurred on the same day.

The overriding determinant is that the Commissioner's regulation is authorized by the statute, and his interpretation of that regulation is not so unreasonable as to be declared invalid by this court on policy grounds. That is not our function or our decision. As the Supreme Court has emphasized, "[w]hen Congress . . . has delegated policymaking authority to an administrative agency, the extent of judicial review of the agency's policy determinations is limited." *Pauley v. BethEnergy Mines, Inc.*, 501 U.S. 680, 696 (1991).

III. CONCLUSION

For the reasons set forth, we agree with the Tax Court, and will affirm its judgment.

UNITED STATES TAX COURT

Connecticut General Life Insurance Company, Petitioner,
v.
Commissioner of Internal Revenue, Respondent.

CIGNA Corporation and Consolidated Subsidiaries, Petitioner,
v.
Commissioner of Internal Revenue, Respondent.

No. 21212-92, 21213-92.
Aug. 12, 1997.

OPINION

SWIFT, Judge:

These consolidated cases are before the Court under Rule 121 on the parties' cross-motions for summary judgment. Petitioners contend that if their motion for summary judgment is not granted, a certain factual matter remains in dispute that precludes summary judgment in favor of respondent.

The issue for decision is whether, in consolidating nonlife insurance companies (sometimes referred to as nonlife companies) with life insurance companies (sometimes referred to as life companies) and for purposes of calculating, under section 1503(c)(1) and (2), the amount of net operating losses of nonlife companies that may reduce income of life companies, companies that constituted members of a "recently acquired" affiliated group of nonlife companies that previously filed consolidated Federal income tax returns are to be treated as a single aggregate entity, as petitioners contend, or as separate entities, as respondent contends.

The issue presented in these cross-motions for summary judgment involves deficiencies determined by respondent in the Federal income taxes of petitioners Connecticut General Life Insurance Co. (ConnLife) and CIGNA Corp. and their consolidated subsidiaries (CIGNA) as follows:

Petitioner	*Year*	*Deficiency*
ConnLife	1980	$ 3,360,873
CIGNA	1982	15,080,878
CIGNA	1983	1,916,121
CIGNA	1984	41,066,157
CIGNA	1985	752,636
Total		$62,176,665

Unless otherwise indicated, all section references are to the Internal Revenue Code in effect for the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

For 1981 and through March 31, 1982, Connecticut General Corp. (CG), ConnLife, and CG's over 40 affiliates (the CG group) joined in filing consolidated Federal income tax returns, with CG as the common parent of the affiliated group. ConnLife constituted the sole life insurance company in the CG group. Members of the CG group were engaged primarily in selling, underwriting, and servicing various types of insurance (namely, individual and group life, health and annuity insurance, and personal and commercial property and casualty (P & C) insurance).

Acquisition of INA

On March 31, 1982, the CG group and INA Corp. (INA) and its over 160 affiliated companies (the INA group) combined for substantial business reasons by way of a tax-free

reorganization under section 368. As the culmination of the reorganization, CIGNA was incorporated on March 31, 1982, as the holding company for the surviving affiliated business entities.

In years prior to the combination of the CG and the INA groups, INA and its affiliates had filed consolidated Federal income tax returns, with INA as the common parent corporation of the affiliated INA group. Members of the INA group were engaged primarily in selling, underwriting, and servicing P & C insurance.

The reorganization involving the CG and the INA groups was treated as a reverse acquisition under section 1.1502-75(d)(3), Income Tax Regs. After the reorganization and for Federal income tax purposes, the CG group was treated as continuing in existence and the INA group was treated as ceasing to exist. CIGNA was treated as the common parent corporation of the continuing CG group (the CIGNA group), and companies that constituted members of the former INA group became members of the CIGNA group.

Acquisition of PHC

On November 20, 1984, an affiliate of CIGNA acquired 89.9 percent of the stock of Preferred Health Care, Inc. (PHC), in a taxable transaction. As a result of this transaction, PHC and its subsidiary companies (the PHC group) terminated, and companies that constituted members of the former PHC group became members of the CIGNA group.

In years prior to the acquisition by CIGNA of PHC and its subsidiary companies, PHC and its subsidiaries had filed consolidated Federal income tax returns, with PHC as the common parent corporation of the affiliated PHC group. The PHC group operated prepaid dental programs in Florida, New Jersey, and eastern Pennsylvania.

Consolidated Federal Income Tax Returns of the CIGNA Group

For 1982 through 1985, the consolidated Federal income tax returns that were filed on behalf of the CIGNA group included the companies that constituted members of the former INA group.

For 1984 and 1985, the consolidated Federal income tax returns that were filed on behalf of the CIGNA group also included the companies that constituted members of the former PHC group.

For 1982 through 1985, under a special rule set forth in section 1504(c) allowing life insurance companies to file consolidated Federal income tax returns with nonlife affiliated companies, ConnLife was included as the sole life insurance company in the above consolidated Federal income tax returns of the CIGNA group.

For 1982 through 1985, all of the nonlife companies that constituted members of the CIGNA group incurred the following consolidated net operating losses (CNOL's), and ConnLife, the only life insurance company in the CIGNA group, earned the following income:

Year	*CNOL's of nonlife companies*	*Income of ConnLife*
1982	($197,385,675)	$116,294,363
1983	(244,963,449)	82,316,221
1984	(553,077,555)	331,452,903
1985	(1,229,220,860)	274,458,803

The above CNOL's of the nonlife companies consisted of CNOL's of both eligible companies under section 1503(c)(2) (namely, nonlife companies that had been members of the prior

CG group and the CIGNA group for at least 5 years) and ineligible companies under section 1503(c)(2) (namely, nonlife companies that had not been members of the prior CG group and the CIGNA group for at least 5 years). Because they had not been members of the prior CG group and the CIGNA group for at least 5 years, all of the companies that constituted members of the former INA and PHC groups constituted ineligible nonlife companies.

On the consolidated Federal income tax returns for 1982 through 1985 — in order to calculate the amount of net operating losses (NOL's) attributable to the nonlife companies that had previously constituted members of the former INA and PHC groups and that therefore constituted losses of ineligible companies that could not be used to reduce income of ConnLife (the sole life company in the consolidated CIGNA group) — the CIGNA group treated all of the companies that constituted members of the former INA and PHC groups as two single, aggregate, respective entities, and the net aggregate respective losses of the companies that constituted members of the former INA group and the former PHC group were netted against the respective taxable income of the other companies that constituted members of the former INA group and the former PHC group (single entity method). In other words, for purposes of calculating the portion of the net operating losses of the nonlife companies that constituted members of the former INA group that, on the CIGNA group's consolidated Federal income tax returns for 1982 through 1985, were not allowed to reduce income of ConnLife, all companies that constituted members of the former INA group were treated as a single aggregate entity, and losses of the ineligible companies that constituted members of the former INA group were reduced by income earned by other companies that constituted members of the former INA group.

Further, for purposes of calculating the portion of the net operating losses of the nonlife companies that constituted

members of the former PHC group that, on the CIGNA group's consolidated Federal income tax returns for 1984 and 1985, were not allowed to reduce the income of ConnLife, all of the companies that constituted members of the former PHC group were treated as a single aggregate entity, and losses of the companies that constituted members of the former PHC group were reduced by income earned by other companies that constituted members of the former PHC group.

On audit, for 1982 through 1985, in order to calculate the amount of net operating losses attributable to the nonlife companies that had previously constituted members of the former INA and PHC groups and that therefore constituted losses of "ineligible" companies that could not be used to reduce income of ConnLife, respondent determined that each of the companies that constituted members of the former INA and PHC groups should be treated as a separate entity (separate entity method), rather than merely as a part of the respective former INA and PHC groups.

The difference between petitioners' single entity method and respondent's separate entity method is that under petitioners' single entity method losses of the ineligible nonlife companies of the former INA and PHC groups were, in effect, indirectly made available to reduce income of ConnLife, the life company. Under respondent's separate entity method losses of ineligible nonlife companies of the former INA and PHC groups are not, to any extent, made available to reduce income of ConnLife.

The following schedule reflects for each of the years 1982 through 1985 petitioners' and respondent's respective calculations of the amount of nonlife CNOL's that they claim should be available under section 1503(c)(1) and (2) and the regulations thereunder to reduce ConnLife's income:

*Nonlife CNOL's eligible to reduce income of ConnLife**

Year	*Petitioners' single entity method*	*Respondent's separate entity method*
1982	($34,888,309)	($10,225,979)
1983	(28,810,677)	(8,351,216)
1984	(116,008,516)	(26,734,260)
1985	(96,060,581)	(94,424,416)

* These figures reflect CNOL's after application of certain percentage limitations contained in sec. 1503.

Discussion

Summary judgment may be granted if the pleadings and other materials demonstrate that no genuine issue exists as to any of the material facts and that a decision may be rendered as a matter of law. Rule 121(b); *Colestock v. Commissioner*, 102 T.C. 380, 381 (1994); *Sundstrand Corp. v. Commissioner*, 98 T.C. 518, 520 (1992), *aff'd*, 17 F.3d 965 (7th Cir.1994).

Under section 1504(c)(2) and subject to certain limitations not here relevant, an affiliated group of companies that includes nonlife and life companies may elect to file consolidated Federal income tax returns and to include the life companies in the consolidated income tax returns. Sec. 1504(c)(2).

The above election to consolidate on a limited basis nonlife and life companies was added to the Code as part of the Tax Reform Act of 1976, Pub. L. 94-455, sec. 1507(a), 90 Stat. 1739, in order that nonlife companies (such as P & C insurance companies, which P & C industry had been experiencing losses and a diminished capacity to write insurance) could use nonlife

losses to reduce income of affiliated life companies. Congress anticipated that the option to consolidate nonlife and life companies would, in particular, improve the financial condition of P & C insurance companies. *See* S. Rept. 94-938, at 454-455 (1976), 1976-3 C.B. (Vol. 3) 49, 492-493.

Congress, however, in order to minimize trafficking by profitable life insurance companies in unprofitable P & C insurance companies, provided certain rules and limitations on the use in consolidated Federal income tax returns of nonlife losses to reduce life income. *See* S. Rept. 94-938, *supra* at 454-455, 1976-3 C.B. (Vol. 3) at 492-493; 122 Cong. Rec. 24680-24685 (1976).

Section 1503(c)(1) provides generally that where an election is made under section 1504(c)(2) to include both nonlife and life companies in a consolidated Federal income tax return, certain losses of nonlife companies may be taken into account and may reduce income of the life companies included in the return but only pursuant to regulations prescribed by the Secretary. Sec. 1503(c)(1).

Section 1503(c)(1) also provides that nonlife losses must first be carried back against prior year income of the particular nonlife companies that incurred the losses, and nonlife losses that are not absorbed as carrybacks against prior year income of the nonlife companies may be applied against income of the life companies to the extent of only 35 percent of the nonlife CNOL or 35 percent of the income of the life companies, whichever is less.[1] Section 1503(c)(1) provides in part as follows:

> (1) In general — If an election under section 1504(c)(2) is in effect for the taxable year and the consolidated taxable

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[1] For 1982, sec. 1503(c)(1) limits the losses that are allowed to reduce life income to 30 percent of the income of the life companies or 30 percent of the nonlife CNOL, whichever is less.

> income of the * * * [nonlife members of the group] results in a consolidated net operating loss for such taxable year, then under regulations prescribed by the Secretary, the amount of such loss which cannot be absorbed in the applicable carryback periods against the taxable income of such * * * [nonlife members of the group] shall be taken into account in determining the consolidated taxable income of the affiliated group for such taxable year to the extent of 35 percent of such loss or 35 percent of the taxable income of the * * * [life members of the group], whichever is less. * * *

Section 1503(c)(2) provides a further specific limitation on the use of nonlife losses to reduce life income where the particular nonlife losses that are involved are realized by companies that were not, for the immediately preceding 5 years, part of the same affiliated group that is now filing a consolidated Federal income tax return. Section 1503(c)(2) provides in pertinent part as follows:

> a net operating loss for a taxable year of a * * * [nonlife member of the group] shall not be taken into account in determining the taxable income of a * * * [life member of the group] if such taxable year precedes the sixth taxable year such members have been members of the same affiliated group * * *.

Under legislative regulations promulgated under sections 1502 and 1503, for purposes of calculating the amount of nonlife losses that is allowed to reduce life income pursuant to section 1503(c)(2), each nonlife company that constitutes a member of the consolidated group is treated as a separate entity, and the CNOL of all of the nonlife companies included in the consolidated Federal income tax return (after allowable carrybacks) is reduced by the separate "ineligible NOL" of each ineligible nonlife company that constitutes a member of the consolidated group. Sec. 1.1502-47(m)(3)(vi), Income Tax

Regs. Section 1.1502-47(m)(3)(vi)(A), Income Tax Regs., provides, in pertinent part, as follows:

> the "ineligible NOL" is in the year the loss arose the amount of the separate net operating loss * * * of any nonlife member that is ineligible in that year * * *.

No provision is made in the above legislative regulations to treat a company that prior to acquisition had been a member of a group that had filed a consolidated income tax return as part of a single, aggregate group of companies and to net within that group losses of ineligible nonlife companies against income of other nonlife companies of the same acquired group.

Petitioners note, however, that the legislative regulations under sections 1502 and 1503 provide a "reserved" subparagraph for "acquired groups". Sec. 1.1502-47(m)(4), Income Tax Regs. That reserved subparagraph states merely as follows: "*Acquired Groups*. [Reserved.]".

Petitioners note further that in the preamble accompanying section 1.1502-47, Income Tax Regs., a comment is made to the effect that applying petitioners' single entity method to ineligible nonlife companies that in prior years constituted members of a consolidated group may be appropriate in certain situations.

The preamble states in relevant part:

> Finally, the Treasury Department will study further whether it is appropriate to aggregate the income and losses of ineligible members in certain cases. For instance, notwithstanding the ordinary reading of section 1503(c)(2), it may be consistent with the intent of section 1503(c)(2), or correct as a matter of policy, to aggregate the income and losses of ineligible members that filed a consolidated return prior to their acquisition by * * * another group that files a consolidated return. [T.D. 7877, 1983-1 C.B. 207, 212.]

Due primarily to the presence of the above reserved subparagraph for acquired consolidated groups and due to the above language from the preamble to the regulations, petitioners argue that the separate entity treatment for ineligible nonlife companies that is provided in section 1503(c)(2) and section 1.1502-47(m)(3)(vi), Income Tax Regs., should itself be limited and should not apply to ineligible nonlife companies that previously constituted an affiliated group and that filed consolidated Federal income tax returns (e.g., the companies that constituted members of the former INA and PHC groups).

Petitioners cite portions of the Department of the Treasury (Treasury) administrative files under section 1.1502-47(m)(3) and (4), Income Tax Regs., that suggest that the insurance industry in general and petitioners in particular were engaged with respondent and the Treasury over a period of years in extensive discussions regarding whether a separate or a single entity method should be adopted and reflected in the regulations with regard to the treatment of losses of ineligible nonlife companies that constituted part of a previously affiliated and consolidated group. Portions of the referenced administrative files also reflect positions or recommendations of various Government officials about the separate or single entity method and indicate that some Government officials at one time or another favored a single entity method.

Petitioners argue that the administrative files establish that, in the regulations, the Treasury and respondent never adopted a final decision as to how to treat losses of ineligible nonlife companies that constituted part of a previously affiliated and consolidated group and that the "reserved" subparagraph (4) under section 1.1502-47(m), Income Tax Regs., was intended to preserve this issue until that subparagraph was promulgated.

Petitioners further argue that in the absence of a rule under the regulations as to how to treat losses of ineligible nonlife companies that constituted part of a previously affiliated and consolidated group, the statutory and regulatory provisions are

unclear and ambiguous, and petitioners should be entitled to treat losses of the respective ineligible nonlife companies that constituted members of the former INA and PHC groups under any reasonable interpretation of the statute. Petitioners then argue that treating members of the former INA group and members of the former PHC group as two single nonlife entities constitutes a reasonable approach.

Additionally, if we agree with respondent's interpretation of section 1.1502-47(m)(3)(vi), Income Tax Regs., with regard to the companies that constituted members of the former INA and PHC groups, petitioners argue that the regulation should be invalidated.

Petitioners also argue that a calculation of the ineligible CNOL's using respondent's separate entity method would cause an increased overall tax liability for the CIGNA group, as compared to the collective tax liabilities of the CIGNA group and the former INA and PHC groups, assuming the former INA and the PHC groups had never been acquired. Petitioners thus conclude that any such calculation would constitute an improper, punitive calculation.

We disagree with each of petitioners' arguments.

We agree with respondent's interpretation of the statutory and regulatory provisions involved in these cases. As indicated, section 1503(c)(1) provides generally that losses of ineligible nonlife companies may be used to reduce income of life companies but only pursuant to regulations promulgated by the Treasury and subject to the limitations contained in section 1503(c)(1) and (2). Also as indicated, the legislative regulations that were promulgated by the Treasury generally reflect a separate entity method when calculating, under section 1503(c)(2), the amount of nonlife losses that are to be attributed to ineligible nonlife companies and therefore that may not be used to reduce income of life companies. The statute and the regulations do not reflect any special treatment

for losses of ineligible nonlife companies that previously constituted an affiliated and consolidated group.

We regard the "reserved" subparagraph (4) under section 1.1502- 47(m), Income Tax Regs., as a neutral factor. That provision simply reserves a space for regulations that may be promulgated at a later date and that may provide a special rule with regard to losses of ineligible nonlife companies that previously constituted an affiliated and consolidated group.

We regard the preamble language to the regulations as merely reflecting the Treasury's willingness to study whether a special rule should be promulgated for acquired previously affiliated and consolidated groups. That language is not to be construed as indicating that section 1.1502-47(m)(3)(vi), Income Tax Regs., and the separate entity method reflected therein do not apply to ineligible nonlife companies that previously constituted an affiliated and consolidated group.

Petitioners' arguments that are based on certain material in the Treasury's administrative files under section 1.1502-47(m)(3) and (4), Income Tax Regs., are not persuasive. The documents from the administrative files are not compelling, consistent, or clear as to the intended treatment of losses of ineligible nonlife companies that constituted part of a previously affiliated and consolidated group. Also, the relied-upon material from the administrative files reflects generally only personal views of various Government representatives, not official statements of respondent or of the Treasury. *See Armco, Inc. v. Commissioner*, 87 T.C. 865, 867-868 (1986).

In any event, personal views of such Government representatives would not be able to overcome the particular statutory and regulatory scheme before us in these cases. In light of this statutory and regulatory scheme, petitioners' alleged factual matter in dispute (namely, the intent of such Government representatives) is simply not sufficiently relevant

to the resolution of the issue to give rise to a genuine issue of material fact. Rule 121(b).

We emphasize that section 1503(c)(1) provides that nonlife losses may be taken into account only "under regulations prescribed by the Secretary". Assuming arguendo that the above reserved subparagraph (4) of section 1.1502-47(m), Income Tax Regs., was intended and should be construed as petitioners would have us construe it (namely, as exempting from the general separate entity method of the regulations ineligible nonlife companies that previously had been members of an affiliated and consolidated group), petitioners arguably would be left without any specific regulatory provision that would support their single entity method for such nonlife companies. Because section 1503(c)(1) provides that nonlife losses may be taken into account only as provided in regulations, the absence of any such regulation might preclude petitioners from taking into account any of the losses of the ineligible nonlife companies that previously constituted members of the former INA and PHC groups. *See Estate of Neumann v. Commissioner*, 106 T.C. 216, 219-221 (1996); *H Enters. Intl., Inc. v. Commissioner*, 105 T.C. 71, 81-83 (1995); *Alexander v. Commissioner*, 95 T.C. 467, 473 (1990), *aff'd without published opinion sub nom. Stell v. Commissioner*, 999 F.2d 544 (9th Cir. 1993).

We simply are not persuaded by petitioners' arguments. As indicated, the regulations in question are legislative in nature. Pursuant to sections 1502 and 1503(c)(1), the Treasury was given an express delegation of regulatory authority. Respondent's interpretation of the legislative regulations in these cases is sufficiently consistent with section 1503(c)(2) and its legislative purpose to restrict the use of ineligible nonlife losses against life income. Also, respondent's interpretation is not so clearly inconsistent with the statute or its purpose as to be arbitrary and capricious and invalid. *See Chevron, U.S.A.*,

Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 844 (1984).

Finally, petitioners' argument as to the punitive effect of the separate entity method does not justify a different result. Under the separate entity method, the CIGNA group still obtains benefits in consolidating nonlife and life companies (i.e., the ability to offset some nonlife losses against life income). Also, as indicated, section 1.1502-47(m)(3)(vi), Income Tax Regs., is consistent with congressional intent to place some limits on the use of ineligible nonlife losses to reduce income of life companies. Further, under the regulations, ineligible losses of nonlife companies are not completely lost, and such losses may be carried back or forward and used to reduce consolidated taxable income of nonlife companies in other years. Sec. 1.1502- 47(m)(3)(vii), Income Tax Regs.

For the reasons stated, we conclude that, for the years in issue, section 1.1502-47(m)(3)(vi), Income Tax Regs., applies to the companies that previously constituted members of the former INA and PHC groups for purposes of calculating the amount of losses of the nonlife companies of the CIGNA group that may be used to reduce the income of ConnLife. The CIGNA group is required to treat each of the nonlife companies that previously constituted members of the former INA and the former PHC groups as a separate entity.

We also conclude that no factual matter remains in dispute that precludes our granting summary judgment in favor of respondent.

We have considered petitioners' other arguments and find them unpersuasive.

To reflect the foregoing,

Appropriate orders and decisions will be entered for respondent.

PERTINENT STATUTORY AND REGULATORY PROVISIONS

TITLE 26—INTERNAL REVENUE CODE (1994)

CHAPTER 6 — CONSOLIDATED RETURNS

Subchapter A—Returns and Payment of Tax

26 U.S.C. § 1501. Privilege to file consolidated returns

An affiliated group of corporations shall, subject to the provisions of this chapter, have the privilege of making a consolidated return with respect to the income tax imposed by chapter 1 for the taxable year in lieu of separate returns. The making of a consolidated return shall be upon the condition that all corporations which at any time during the taxable year have been members of the affiliated group consent to all the consolidated return regulations prescribed under section 1502 prior to the last day prescribed by law for the filing of such return. The making of a consolidated return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year, the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group.

26 U.S.C. § 1502. Regulations

The Secretary shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income-tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability.

26 U.S.C. § 1503. Computation and payment of tax

(a) [General rule][1]

In any case in which a consolidated return is made or is required to be made, the tax shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations under section 1502 prescribed before the last day prescribed by law for the filing of such return.

[(b) Repealed. Pub. L. 94-455, title X, § 1052(c)(5), Oct. 4, 1976, 90 Stat. 1648]

(c) Special rule for application of certain losses against income of insurance companies taxed under section 801

(1) In general

If an election under section 1504(c)(2) is in effect for the taxable year and the consolidated taxable income of the members of the group not taxed under section 801 results in a consolidated net operating loss for such taxable year, then under regulations prescribed by the Secretary, the amount of such loss which cannot be absorbed in the applicable carryback periods against the taxable income of such members not taxed under section 801 shall be taken into account in determining the consolidated taxable income of the affiliated group for such taxable year to the extent of 35 percent of such loss or 35 percent of the taxable income of the members taxed under section 801, whichever is less. The unused portion of such loss shall be available as a carryover, subject to the same limitations (applicable to the sum of the loss for the carryover year and the loss (or losses) carried over to such year), in applicable carryover years.

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[1] Subsec. (a) heading editorially supplied.

(2) Losses of recent nonlife affiliates

Notwithstanding the provisions of paragraph (1), a net operating loss for a taxable year of a member of the group not taxed under section 801 shall not be taken into account in determining the taxable income of a member taxed under section 801 (either for the taxable year or as a carryover or carryback) if such taxable year precedes the sixth taxable year such members have been members of the same affiliated group (determined without regard to section 1504(b)(2)).

* * *

26 U.S.C. § 1504. Definitions

(a) Affiliated group defined

For purposes of this subtitle—

(1) In general

The term "affiliated group" means—

(A) 1 or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation, but only if—

(B)(i) the common parent owns directly stock meeting the requirements of paragraph (2) in at least 1 of the other includible corporations, and

(ii) stock meeting the requirements of paragraph (2) in each of the includible corporations (except the common parent) is owned directly by 1 or more of the other includible corporations.

* * *

(b) Definition of "includible corporation"

As used in this chapter, the term "includible corporation" means any corporation except—

(1) Corporations exempt from taxation under section 501.

(2) Insurance companies subject to taxation under section 801.

* * *

(c) Includible insurance companies

Notwithstanding the provisions of paragraph (2) of subsection (b)—

(1) Two or more domestic insurance companies each of which is subject to tax under section 801 shall be treated as includible corporations for purposes of applying subsection (a) to such insurance companies alone.

(2)(A) If an affiliated group (determined without regard to subsection (b)(2)) includes one or more domestic insurance companies taxed under section 801, the common parent of such group may elect (pursuant to regulations prescribed by the Secretary) to treat all such companies as includible corporations for purposes of applying subsection (a) except that no such company shall be so treated until it has been a member of the affiliated group for the 5 taxable years immediately preceding the taxable year for which the consolidated return is filed.

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26 U.S.C. § 1505. Cross references

* * *

26 C.F.R. § 1.1502-47 Consolidated returns by life-nonlife groups.

(a) ***Scope*** — (1) *In general.* Under section 1504(b)(2), insurance companies that are taxed under section 802 or 821 (relating respectively to life insurance companies and to certain mutual insurance companies) are not treated as includible

corporations for purposes of determining under section 1504(a) the existence of an affiliated group and the composition of its membership. Section 1504(c)(2) provides an election whereby certain life insurance companies and mutual insurance companies may be treated as includible corporations, and thus members, of a group composed of other includible corporations. This section provides regulations for the making of this election and for the determination of an electing group's composition and its consolidated tax liability.

(2) *General method of consolidation* — (i) Subgroup method. The regulations adopt a subgroup method to determine consolidated taxable income. One subgroup is the group's nonlife companies (including those taxable under section 821). The other subgroup is the group's life insurance companies. Initially, the nonlife subgroup computes nonlife consolidated taxable income and the life subgroup computes consolidated partial life insurance company taxable income. A subgroup's income may in effect be reduced by a loss of the other subgroup. The life subgroup losses consist of consolidated loss from operations and life consolidated net capital loss. The nonlife subgroup losses consist of nonlife consolidated net operating loss and nonlife consolidated net capital loss. Consolidated taxable income is therefore defined in pertinent part as the sum of nonlife consolidated taxable income and consolidated partial life insurance company taxable income reduced by life subgroup losses or nonlife subgroup losses.

(ii) *Subgroup loss*. A subgroup loss does not actually affect the computation of nonlife consolidated taxable income or consolidated partial life insurance company taxable income. It merely constitutes a bottom-line adjustment in reaching consolidated taxable income. Furthermore, one subgroup's loss must first be carried back against income of the same subgroup before it may be used as a setoff against the second subgroup income in the taxable year the loss arose. (See section 1503(c)(1)). The carryback of the losses from one

subgroup may not be used to offset income of the other subgroup in the year to which the loss is to be carried. This carryback of the first subgroup's loss may "bump" the second subgroup's loss that in effect previously reduced the income of the first subgroup. The second subgroup's loss that is bumped in appropriate cases may in effect reduce a succeeding year's income of the second or first subgroup. This approach gives the group the tax savings of the use of losses but the bumping rule assures that insofar as possible life deductions will be matched against life income and nonlife deductions against nonlife income.

(iii) *Carryover of subgroup loss.* A subgroup's loss may be used in a succeeding year, but in any particular succeeding year the loss must be used to reduce the income of the same subgroup before it may be used as a setoff against the other subgroup's income.

(3) *Authority.* This section is prescribed under the authority of sections 1502, 1503(c), 1504(c)(2), and 7805(b).

(4) *Other provisions.* The provisions of §§ 1.1502-1 through 1.1502-80 apply unless this section provides otherwise. Further, unless otherwise indicated in this section, a term used in this section has the same meaning as in sections 801-844.

(b) ***Effective date.*** This section is effective for taxable years for which the due date (without extensions) for filing returns is after March 14, 1983.

(c) ***Cross references.*** The following table provides cross references for some of the definitions and operating rules that are relevant in making the election and determining the group's composition and its tax liability:

* * *

(d) Definitions. For purposes of this section:

(1) *Life insurance company.* The term "life company"

means a life insurance company as defined in section 801. Section 801 applies to each company separately.

(2) *Mutual insurance company*. The term "mutual company" means a mutual insurance company taxable under section 821(a)(1).

(3) *Life insurance company taxable income*. The term "life insurance company taxable income" is referred to as LICTI. The terms "TII", "GO", and "LO" refer, respectively, to taxable investment income (section 804), gain from operations (section 809), and loss from operations (section 812). The term "consolidated partial LICTI" refers to consolidated LICTI without section 802(b)(3).

(4) *Group*. The term "group" means an affiliated group of corporations (as defined in section 1504(a)). Unless otherwise indicated in this section, a group's composition is determined without section 1504(b)(2).

(5) *Member*. The term "member" means a corporation (including the common parent) that is an includible corporation in the group. A life company or mutual company is tentatively treated as a member for any taxable year for purposes of determining if it is an eligible corporation under paragraph (d)(12) of this section and therefore if it is an includible corporation under section 1504(c)(2). If such a company is eligible and includible (under section 1504(c)(2)), it will actually be treated as a member of the group.

(6) *Life member*. A life member is a member of the group that is a life company.

(7) *Nonlife member*. A nonlife member is a member of the group that is not a life company.

(8) *Life subgroup*. A life subgroup is composed of those members that are life members. If the group has only one life member, it constitutes a life subgroup.

(9) *Nonlife subgroup.* A nonlife subgroup is composed of those members that are nonlife members. If the group has only one nonlife member, it constitutes a nonlife subgroup.

(10) *Separate return year.* The term "separate return year" means a taxable year of a corporation for which it files a separate return or for which it joins in the filing of a consolidated return by another group. For purposes of this subparagraph (10), the term "group" is defined with regard to section 1504(b)(2) for years in which an election under section 1504(c)(2) is not in effect. Thus, a separate return year includes a taxable year for which that election is not in effect.

(11) *Separate return limitation year.* Section 1.1502-1(f)(2) provides exceptions to the definition of the term "separate return limitation year". For purposes of applying those exceptions to this section, for taxable years ending after December 31, 1980, the term "group" is defined without regard to section 1504(b)(2) and the definition in this subparagraph (11) applies separately to the nonlife subgroup in determining nonlife consolidated taxable income under paragraph (h) of this section and to the life subgroup in determining consolidated partial LICTI under paragraph (j) of this section. Paragraph (m)(3)(ix) of this section defines the term "separate return limitation year" for purposes of determining whether the losses of one subgroup may be used against the income of the other subgroup.

(12) *Eligible corporations* — (i) *In general.* A corporation is an eligible corporation for a taxable year of a group only if, throughout every day of the base period the corporation:

(A) Was in existence and a member of the group determined without the exclusions in section 1504(b)(2) (see paragraphs (d)(12)(iii)-(vi) of this section),

(B) Was engaged in the active conduct of a trade or business ("active business"),

(C) Did not experience a change in tax character (see paragraph (d)(12)(vii) of this section), and

(D) Did not undergo disproportionate asset acquisitions (see paragraph (d)(12)(viii) of this section).

(ii) *Base period.* The base period consists of the common parent's five taxable years immediately preceding the group's taxable year for which the consolidated return and the determination of eligibility are made. Eligibility is determined for each consolidated return year beginning with the first year for which the election under section 1504(c)(2) is effective.

(iii) *In existence.* Except as provided in paragraph (d)(12)(v) and (vi) of this section, a corporation organized after the base period begins is not eligible even though it is a member of the group immediately after its organization. For purposes of this subdivision (iii), a corporation that was a party to a reorganization described in section 368(a)(1)(F) shall be treated as the same entity both before and after the reorganization.

(iv) *Membership period.* Except as provided in paragraph (d)(12)(v) and (vi) of this section, a corporation must have been a member of the group throughout the base period to be eligible. Thus, an ineligible corporation includes one whose stock was acquired from outside the group at any time during the base period or one which was a member of a different group (whether by application of reverse acquisition rules in § 1.1502-75(d)(3) or otherwise) at any time during the base period. For purposes of this subdivision (iv), the common parent of a group is treated as constituting a group (and hence is a member) during any period when it was not a member of an affiliated group within the meaning of section 1504(a) (applied without section 1504(b)(2)).

(v) *Tacking rule.* The period during which an "old" corporation is in existence and a member of the group engaged in active business is included in (or "tacks" onto) the period for the "new" corporation if the following five conditions listed in

this subdivision (v) are met. For purposes of this subparagraph (12), a "new" corporation is a corporation (whether or not newly organized) during the period its eligibility depends upon the tacking rule. The five conditions are as follows:

(A) The first condition is that, at any time, 80 percent or more of the new corporation's assets it acquired (other than in the ordinary course of its trade or business) where acquired from the old corporation in one or more transactions described in section 351(a) or 381(a). This asset test is applied by using the fair market values of assets on the date they were acquired and without regard to liabilities. Assets acquired in the ordinary course of business will be excluded from total assets only if they were acquired after the new corporation became a member of the group (determined without section 1504(b)(2)). In addition, assets that the old corporation acquired from outside the group in transactions not conducted in the ordinary course of its trade or business are not included in the 80 percent (but are included in total assets) if the old corporation acquired those assets within five calendar years before the date of their transfer to the new corporation.

(B) The second condition is that at the end of the taxable year during which the first condition is first met, the old corporation and the new corporation must both have the same tax character. For purposes of this paragraph (d)(12), a corporation's tax character is the section under which it would be taxed (i.e., sections 11, 802, 821, or 831) if it filed a separate return. If the old corporation is not in existence (or adopts a plan of complete liquidation) at the end of that taxable year, this subdivision (v)(B) will apply to the old corporation's taxable year immediately preceding the beginning of the taxable year during which the first condition is first met.

(C) The third condition is that, if the old and new corporation are life insurance companies, the transfer (or transfers) is not reasonably expected (at the time of the

transfer) to result in the separation of profitable activities from loss activities.

(D) The fourth condition is that, at the end of the taxable year during which the first condition is first met, the new corporation does not undergo a disproportionate asset acquisition under paragraph (d)(12)(viii) of this section.

(E) The fifth condition is that, if there is more than one old corporation, the first three conditions apply to all of the corporations. Thus, the second condition (tax character) must be met by all of the old corporations transferring assets taken into account in meeting the test in paragraph (d)(12)(v)(A) of this section.

(vi) *Old group remaining in existence.* If the common parent of a group (or a new common parent) became the common parent in a transaction described in § 1.1502-75(d)(2) or (d)(3) where a group remained in existence, then paragraph (d)(12)(ii)-(iv) of this section apply by treating that common parent as if it were also the previous common parent of the group that remains in existence. If this paragraph (d)(12)(vi) applies to a transaction, the tacking rule in paragraph (d)(12)(v) of this section does not apply to the transaction.

(vii) *Change in tax character.* A corporation must not experience during the base period a change in tax character (as defined in paragraph (d)(12)(v)(B) of this section) if the change is attributable to an acquisition of assets from outside the group in transactions not conducted in the ordinary course of its trade or business. However, if a new corporation relies on the tacking rules in paragraph (d)(12)(v) of this section, this paragraph (d)(12)(vii) shall apply during the base period and the current consolidated return year and even if the change in tax character is attributable to an asset acquisition from within the group.

(viii) *Disproportionate asset acquisition.* To be eligible, a corporation must not undergo during the base period dispro-

portionate asset acquisitions which are attributable to an acquisition (or a series of acquisitions) of assets from outside the group in transactions not conducted in the ordinary course of its trade or business (special acquisition). Whether special acquisitions are disproportionate is determined at the end of each base period. Whether an acquisition results in a disproportionate asset acquisition depends on all of the facts and circumstances including the following factors and rules:

(A) One factor is the portion of the insurance reserves (i.e., total reserves in section 801(c)) of the acquiring company at the end of the base period which is attributable to special acquisitions.

(B) A second factor is the portion of the fair market value of the assets (without reduction for liabilities) of the acquiring company at the end of the base period that is attributable to special acquisitions.

(C) A third factor is the portion of the premiums generated during the last taxable year of the base period which are attributable to special acquisitions.

(D) A corporation will not experience a disproportionate asset acquisition unless 75 percent of one factor (whether or not listed in this subdivision (viii)) is attributable to special acquisitions.

(E) Money or other property contributed to a corporation by a shareholder that is not a member of the group (without section 1504(b)(2)) is not a special acquisition.

(F) If a new corporation relies on the tacking rules in paragraph (d)(12)(v) of this section, this subdivision (viii) applies to that corporation during a consolidated return year. Thus, if at any time during a consolidated return year, a new corporation undergoes a disproportionate asset acquisition, the corporation becomes ineligible at that time.

(13) *Ineligible corporation.* A corporation that is not an eligible corporation is ineligible. If a life company or mutual company is ineligible, it is not treated under section 1504(c)(2) as an includible corporation. Losses of a nonlife member arising in years when it is ineligible may not be used under section 1503(c)(2) and paragraph (m) of this section to set off the income of a life member. If a life or mutual company is ineligible and is the common parent of the group (without section 1504(b)(2)), the election under section 1504(c)(2) may not be made.

(14) *Illustrations.* The following examples illustrate this paragraph (d).

* * *

(e) ***Election*** — (1) *In general.* The election under section 1504(c)(2) may not be made if the group's common parent is an ineligible life company or an ineligible mutual company. The election under section 1504(c)(2) may only be made by the common parent of the group (as defined in section 1504(c)(2) without the exclusions in section 1504(b)(2)). For example, assume that P owns all of the stock of L sub1, an eligible life company, which owns the stock of S sub1. Assume further that P also owns the stock of L sub2, an ineligible life member, which (for more than five years) has owned the stock of a nonlife company, S sub2. Only P may make the election and, if it does so, P, L sub1, and S sub1 may file a consolidated return under this section. L sub2 may not make the election under section 1504(c)(2) and may not file a consolidated return with S sub2.

(2) *How election is made* — (i) General rule. The election under section 1504(c)(2) is generally made by the group's common parent in the same manner (and it has the same effect) as the election to file a consolidated return is made under § 1.1502-75 (a) and (b) for a group which did not file a consolidated return for the immediately preceding taxable year.

The procedure for making the election under section 1504(c)(2) is the same whether or not a consolidated return was filed by the life members or the nonlife members for the immediately preceding taxable year.

(ii) *Special rule.* Notwithstanding the general rule, however, if the nonlife members in the group filed a consolidated return for the immediately preceding taxable year and had executed and filed a Form 1122 that is effective for the preceding year, then such members will be treated as if they filed a Form 1122 when they join in the filing of a consolidated return under section 1504(c)(2) and they will be deemed to consent to the regulations under this section. However, an affiliation schedule (Form 851) must be filed by the group and the life members must execute a Form 1122 in the manner prescribed in § 1.1502- 75(h)(2).

(3) *Irrevocability.* Except as provided in § 1.1502-75(c) and paragraph (e)(4) of this section, the election under section 1504(c)(2) is irrevocable.

(4) *Permission to discontinue* — (i) *General rule.* A "section 1504(c)(2) group" with a common parent that has made the election to file a consolidated return under section 1504(c)(2) in a previous taxable year is granted permission to elect (under § 1.1502-75(c)(2)(ii)) to discontinue filing such a consolidated return for that group's first taxable year for which the regulations under this section are effective. This election to discontinue shall be exercised in the time and manner prescribed in § 1.1502-75(c)(3), except that the group's common parent shall exercise this election to discontinue (and the other members of the section 1504(c)(2) group must comply with this election) by filing appropriate returns. For purposes of this paragraph (e)(4), an appropriate return is either a separate return or a consolidated return that is filed by newly exercising the privilege under § 1.1502-75(a)(1).

(ii) *Types of groups.* (A) A "section 1504(c)(2) group" is an affiliated group which files or filed a consolidated return pursuant to an election under section 1504(c)(2).

(B) A "limited group" is an affiliated group (determined without section 1504(c)(2)) having at least one member which was a member of a section 1504(c)(2) group on the date that the section 1504(c)(2) group elected to discontinue under paragraph (e)(4)(i) of this section.

(iii) *Effect on restoration rules.* If a group ceases to file a consolidated return or terminates or if a member leaves the group, certain items of income, gain, or loss on transactions between members are taken into account under §§ 1.1502-13, 1.1502-18, and 1.1502-19 ("restoration rules"). For purposes of applying these restoration rules solely by reason of an election under paragraph (e)(4)(i) or (e)(4)(v)(A) of this section to discontinue filing consolidated returns as a section 1504(c)(2) group, the following rules apply:

(A) The section 1504(c)(2) group shall not be considered to terminate and no member of that group shall be treated as ceasing to be a member.

(B) Members of that section 1504(c)(2) group that are included in the consolidated return of a limited group for the first taxable year for which the discontinuance is effective shall be considered to be filing a consolidated return as a continuation of the section 1504(c)(2) group. However, a corporation that is not a member of a particular limited group for that taxable year is considered to have a separate return year (and, for purposes of § 1.1502-19(c), not to be a member of a group filing a consolidated return) with respect to that limited group's members.

(C) Section 1.1502-13 shall be applied without regard to paragraph (f)(1)(vii).

(iv) *Illustrations.* The following examples illustrate paragraph (e)(4)(i)- (iii) of this section.

* * *

(v) *Additional rules.* (A) If a group with a taxable year ending in the month of December, 1982, had made the election under section 1504(c)(2) for a taxable year ending prior to December 1, 1982, and if that group meets the conditions of subdivision (vi) of this paragraph (e)(4), then the common parent may elect to discontinue filing a consolidated return for its taxable year ending in the month of December, 1982 (and other members of the section 1504(c)(2) group must comply with this election) by filing appropriate returns (see paragraph (e)(4)(i) of this section) before September 16, 1983.

(B) If a group made the election under section 1504(c)(2) for its taxable year ending in the month of December, 1982, and if that group meets the conditions of subdivision (vi) of this paragraph (e)(4), then the common parent may elect to withdraw the section 1504(c)(2) election (and all other members of the group determined without section 1504(b)(2) comply with the election) by filing before September 16, 1983, any returns for the appropriate taxable years that would have been filed had the section 1504(c)(2) election never been made.

(vi) A group referred to at subdivision (v)(A) or (B) of this paragraph (e)(4) meets the conditions of this subdivision (vi) if it —

(A) Filed before March 16, 1983, a return for its taxable year ending in the month of December, 1982, and

(B) Had not been granted an extension of time beyond March 15, 1983, for the filing of that return.

(vii) *Interest.* For purposes of section 6601(a), interest runs from the original due date (without extensions) for the filing of such returns as are filed pursuant to an election (to

discontinue or withdraw as the case may be) under this paragraph (e)(4).

(5) *Consent to regulations.* If a group does not discontinue filing a consolidated return under paragraph (e)(4) of this section but continues to file a consolidated return for the group's first taxable year for which the regulations under this section are first effective, the members of the group will be deemed to have consented to the regulations under this section.

(6) *Cross reference.* If an election is made under section 1504(c)(2), see § 1.1502-75(e) and (f) for rules that apply for not including (or including) a member or a nonmember in the consolidated return.

(f) ***Effect of election.*** If the common parent makes the election under section 1504(c)(2), the following rules apply:

(1) *Termination of group.* A mere election under section 1504(c)(2) will not cause the creation of a new group or the termination of an affiliated group that files a consolidated return in the immediately preceding taxable year.

(2) *Effect of eligibility.* If a life member is eligible after an election under section 1504(c)(2), it may not be included as a member of an affiliated group as defined in section 1504(c)(1).

(3) *Eligible and ineligible life companies.* If any life company was a member of an affiliated group of life companies (as defined in section 1504(c)(1)) but is ineligible for a taxable year for which the election under section 1504(c)(2) is effective, that year is not a separate return year merely by reason of the election under section 1504(c)(2) in applying §§ 1.1502-13, 1.1502-18, and 1.1502-19 to transactions occurring in prior consolidated return years of that affiliated group. In addition, if more than one ineligible life member of the group (as defined in section 1504(c)(1)) joined in the filing of a consolidated return in the taxable year immediately preceding the year for which the election under section

1504(c)(2) is effective and, solely as a result of the election, one of the ineligible life members becomes the common parent of such a group (section 1504(c)(1)), the group must continue to file a consolidated return. For example, assume that L sub1 owns all of the stock of S sub1 and all of the stock of L sub2. L sub2 owns the stock of L sub3. L sub1, L sub2, and L sub3 are life companies and S sub1 is a nonlife company. Assume further that in 1981, L sub1, L sub2, and L sub3 file a consolidated return but L sub1 makes the election under section 1504(c)(2) for 1982 and L sub2 and L sub3 are ineligible. L sub2 and L sub3 must continue to file a consolidated return in 1982. Moreover, L sub2 could elect in 1982 to file a consolidated return (section 1504(c)(1)) with L sub3 even if they did not file a consolidated return in 1981 with L sub1.

(4) *Inclusion of life company.* If a life company is ineligible in the consolidated return year for which the election is effective, it will be treated as an includible corporation for the common parent's first taxable year in which the company becomes eligible.

(5) *Dividends received deduction.* Section 243(b)(5) defines the term affiliated group for purposes of the election to deduct 100 percent of the qualifying dividends received by a member from another member of the group. Section 246(b)(6) limits certain multiple tax benefits and the deduction itself. Section 243(b)(5) and (6) do not apply to the mutual companies and life companies that are eligible corporations. See section 1504(c)(2)(B)(i). Thus, the common parent of the group may elect to deduct 100 percent of the qualifying dividends received from an ineligible life company.

(6) *Controlled group.* Sections 1563(a)(4), (b)(2)(D), and (b)(3)(C) (insofar as it applies to corporations described in section 1563(b)(2)(D)) do not apply to any eligible or ineligible life company that is a member of the group for a taxable year

during which the election is effective. See paragraph (d)(4) of this section for the definition of group.

(7) *Consolidated tax*. The tax liability of a group for a consolidated return year (before application of credits against that tax) is computed on a consolidated basis by adding together the following taxes:

(i) The tax imposed under section 11 on consolidated taxable income (as determined under paragraph (g) of this section). The taxes imposed under sections 802(a), 821(a), and 831(a) will each be treated as a tax imposed under section 11.

(ii) The tax imposed by section 1201 on consolidated net capital gain (as determined under paragraph (o) of this section) in lieu of the tax imposed under paragraph (f)(7)(i) of this section on that gain.

(iii) Any taxes described in § 1.1502-2 (other than by paragraphs (a), (f), and (h) thereof).

(g) ***Consolidated taxable income***. The consolidated taxable income is the sum of the following three amounts:

(1) *Nonlife consolidated taxable income*. The nonlife consolidated taxable income (as defined in paragraph (h) of this section) of the nonlife subgroup, as set off by the life subgroup losses as provided in paragraph (n) of this section. The amount in this paragraph (g)(1) may not be less than zero.

(2) *Consolidated partial LICTI*. The consolidated partial LICTI (as defined in paragraph (j) of this section) of the life subgroup, as set off by the nonlife subgroup losses as provided in paragraph (m) of this section. The amount in this paragraph (g)(2) may not be less than zero.

(3) *Surplus accounts*. The sum of the amounts subtracted under section 815 from the policyholders' surplus accounts of the life members.

(h) ***Nonlife consolidated taxable income*** — (1) *In general.* Nonlife consolidated taxable income is the consolidated taxable income of the nonlife subgroup, computed under § 1.1502-11 as modified by this paragraph (h). For this purpose, separate taxable income of a member includes separate mutual insurance company taxable income (as defined in section 821(b)) and insurance company taxable income (as defined in section 832).

(2) *Nonlife consolidated net operating loss deduction* — (i) *In general.* In applying §§ 1.1502-21 or 1.1502-21A (as appropriate), the rules in this subparagraph (2) apply in determining for the nonlife subgroup the nonlife net operating loss and the portion of the nonlife net operating loss carryovers and carrybacks to the taxable year.

(ii) *Nonlife CNOL.* The nonlife consolidated net operating loss is determined under §§ 1.1502-21(A)(f) or 1.1502-21(e) (as appropriate) by treating the nonlife subgroup as the group.

(iii) *Carryback.* The nonlife consolidated net operating loss for the nonlife subgroup is carried back under §§ 1.1502-21A or 1.1502-21 (as appropriate) to the appropriate years (whether consolidated or separate) before the loss may be used as a nonlife subgroup loss under paragraphs (g)(2) and (m) of this section to set off consolidated partial LICTI in the year the loss arose. The election under section 172(b)(3)(C) to relinquish the entire carryback period for the net operating loss of the nonlife subgroup may be made by the common parent of the group. Furthermore, the election may be made even though the election under section 812(b)(3) and paragraph (l)(3)(iii) of this section is not made.

(iv) *Subgroup rule.* In determining the portion of the nonlife consolidated net operating loss that is absorbed when the loss is carried back to a consolidated return year beginning after December 31, 1981, §§ 1.1502-21A or 1.1502-21 (as appropriate) is applied by treating the nonlife subgroup as the

group. Therefore, the absorption is determined without taking into account any life subgroup losses that were previously reported on a consolidated return as setting off nonlife consolidated taxable income for the year to which the nonlife loss is carried back.

(v) *Carryover.* The portion of the nonlife consolidated net operating loss that is not absorbed in a prior year as a carryback, or as a nonlife subgroup loss that set off consolidated partial LICTI for the year the loss arose, constitutes a nonlife carryover under this subparagraph (2) to reduce nonlife consolidated taxable income before that portion may constitute a nonlife subgroup loss that sets off consolidated partial LICTI for a particular year.

(vi) *Transitional rules.* The nonlife consolidated net operating loss deduction is subject to a transitional rule limitation in paragraph (h)(3) of this section.

(vii) *Example.* The following example illustrates this paragraph (h)(2).

* * *

(3) *Transitional rule* — (i) *In general.* The portion of the nonlife consolidated net operating loss deduction in a consolidated return year beginning after December 31, 1980 (referred to as "post-1980 year") attributable to net operating losses sustained in separate return years ending before January 1, 1981 (referred to as "pre-1981 year"), is subject to the rules and limitations in this subparagraph (3).

(ii) *Separate nonlife groups.* To determine the limitation, first, identify for the post-1980 year one or more separate affiliated groups of nonlife companies (as defined in section 1504 without section 1504(c)(2)). For this purpose, a single nonlife company may constitute a separate affiliated group if (A) it is not otherwise a member of a separate group or (B) it has a net operating loss sustained in the pre-1981 year that may

be carried over and that year is a separate return limitation year (determined under § 1.1502-1(f) without paragraph (d)(11) of this section).

(iii) *Carryover.* Second, identify the pre-1981 year net operating losses that may be carried over and that are attributable to each separate affiliated group of nonlife companies. The separate return limitation year rules in §§ 1.1502- 21A(c) or 1.1502-21(c) (as appropriate) do not apply to any of these carryovers.

(iv) *Limitation.* Third, treat the last taxable year ending before January 1, 1981, as if in that year there was a consolidated return change of ownership of each such separate affiliated group of nonlife companies and apply the consolidated return change of ownership limitation in § 1.1502-21A(d) to the losses of each group by treating the members of each separate group as old members.

(v) *Examples.* The following examples illustrate this paragraph (h)(3).

* * *

(4) *Nonlife consolidated capital gain net income or loss* — (i) *In general.* In applying §§ 1.1502-22 or 1.1502-22A (as appropriate), the rules in this subparagraph (4) apply in determining for the nonlife subgroup the nonlife consolidated capital gain net income or loss and the portion of the nonlife net capital loss carryovers and carrybacks to the taxable year. In particular, the nonlife consolidated capital gain net income and nonlife consolidated net capital loss are determined under the principles of §§ 1.1502-22 or 1.1502- 22A(a) (as appropriate) by treating the nonlife subgroup as the group.

(ii) *Additional principles.* In applying §§ 1.1502-22A or 1.1502-22 to nonlife consolidated net capital loss carryovers and carrybacks, the principles set forth in paragraphs (h)(2)(iii) through (v) for applying §§ 1.1502-21 or 1.1502-21A (as

appropriate) to nonlife consolidated net operating loss carryovers and carrybacks shall also apply. Further, the portion of nonlife consolidated net capital loss carryovers attributable to losses sustained in taxable years ending before January 1, 1981, is subject to the limitations in paragraph (h)(3) of this section applied by substituting "net capital loss" for the term "net operating loss" and "§ 1.1502-22A(d)" for "§ 1.1502-21A(d)".

(iii) *Special rules.* The nonlife consolidated net capital loss is reduced, for purposes of determining the carryovers and carrybacks under §§ 1.1502- 22A(b)(1) or 1.1502-22(b) by the lesser of:

(A) The aggregate of the additional capital loss deductions allowed under section 822(c)(6) or section 832(c)(5), or

(B) The nonlife consolidated taxable income computed without capital gains and losses.

(i) [Reserved]

(j) ***Consolidated partial LICTI.*** [Reserved]

(k) ***Consolidated TII*** — (1) *General rule.* [Reserved]

(2) *Separate TII.* [Reserved]

(3) *Company's share of investment yield.* [Reserved]

(4) *Life consolidated capital gain net income.* [Reserved]

(5) *Life consolidated net capital loss carryovers and carrybacks.* The life consolidated net capital loss carryovers and carrybacks for the life subgroup are determined by applying the principles of §§ 1.1502-22 or 1.1502-22A (as appropriate) as modified by the following rules in this subparagraph (5):

(i) Life consolidated net capital loss is first carried back (or apportioned to the life members for separate return years) to be absorbed by life consolidated capital gain net income without regard to any nonlife subgroup capital losses and

before the life consolidated net capital loss may serve as a life subgroup capital loss that sets off nonlife consolidated capital gain net income in the year the life consolidated net capital loss arose.

(ii) If a life consolidated net capital loss is not carried back or is not a life subgroup loss that sets off nonlife consolidated capital gain net income in the year the life consolidated net capital loss arose, then it is carried over to the particular year under this paragraph (k)(5) first against life consolidated capital gain net income before it may serve as a life subgroup capital loss that sets off nonlife consolidated capital gain net income in that particular year.

(iii) *Section 818(f).* Capital losses may not be deducted more than once and capital gain will not be included more than once. See section 818(e) and also section 818(f).

(iv) Capital loss carryovers are subject to the transitional rule in paragraph (k)(6) of this section.

(6) *Transitional rule.* The portion of the life consolidated capital loss carryovers attributable to the net capital losses of the life members sustained in separate return years ending before January 1, 1981, is subject to the same limitations as the capital losses of nonlife members in paragraph (h)(4)(iii) of this section by applying the principles of paragraph (h)(3) of this section to each separate affiliated group of life companies.

(l) ***Consolidated GO or LO*** — (1) *General rule.* [Reserved]

(2) *Separate GO.* [Reserved]

(3) *Consolidated operations loss deduction* — (i) *General rule.* The consolidated operations loss deduction is an amount equal to the consolidated operations loss carryovers and carrybacks to the taxable year. The provisions of §§ 1.1502-21 or 1.1502-21A (as appropriate) and section 812 apply to the extent not inconsistent with this paragraph (l)(3).

(ii) *Consolidated offset*. For purposes of applying section 812(b) and (d), the term "consolidated offset" means the increase in the consolidated operations loss deduction which reduces consolidated partial LICTI to zero. For setoff of consolidated LO against nonlife consolidated taxable income, see paragraph (n)(2) of this section.

(iii) *Carrybacks*. A consolidated LO is first carried back to be absorbed by GO of a life member under section 809(d)(4) or consolidated partial LICTI (as the case may be under section 818(f)(2)) for prior consolidated return years (or apportioned to the life members for prior separate return years) without regard to any nonlife subgroup losses that were set off against consolidated partial LICTI and before the consolidated LO may serve as a life subgroup loss to be set off against nonlife consolidated taxable income in the year the consolidated LO arose. The election to relinquish the entire carryback period for the consolidated LO of the life subgroup may be made by the common parent of the group. See section 812(b)(3). Furthermore, the election may be made even though the election under section 172(b)(3)(C) and paragraph (h)(2)(iii) of this section is not made.

(iv) *Carryovers*. If a consolidated LO is not carried back or is not applied as a life subgroup loss that set off nonlife consolidated taxable income in the year the consolidated LO arose, then it is carried over to a particular year under this paragraph (l)(3) first against the GO of a life member under section 809(d)(4) or consolidated partial LICTI (as the case may be under section 818(f)(2)) before it may serve as a life subgroup loss that may be set off against nonlife consolidated taxable income for that particular year.

(v) *Transitional rule*. The portion of a consolidated operations loss deduction that is attributable to LOs sustained in separate return years ending before January 1, 1981, is subject to the same rules and limitations that the nonlife consolidated net operating loss deduction is subject to in

paragraph (h)(3) of this section as applied by identifying separate affiliated groups of life companies.

(4) *Life consolidated capital gain net income or loss.* Life consolidated capital gain net income or loss is determined in the same manner as under paragraph (k)(4) of this section. However, a life member's company share is determined under section 809(a) and (b)(3).

(m) ***Consolidated partial LICTI setoff by nonlife subgroup losses*** — (1) *In general.* The nonlife subgroup losses consist of the nonlife consolidated net operating loss and the nonlife consolidated net capital loss. Under paragraph (g)(2) of this section, consolidated partial LICTI is set off by the amounts of these two consolidated losses specified in paragraph (m)(2) of this section. The setoff is subject to the rules and limitations in paragraph (m)(3) of this section.

(2) *Amount of setoff* — (i) *Current year.* Consolidated partial LICTI for the current taxable year is set off by the portion of the nonlife consolidated net operating loss and nonlife consolidated net capital loss arising in that year that cannot be carried back under paragraph (h) of this section to prior taxable years (whether consolidated or separate return years) of the nonlife subgroup.

(ii) *Carryovers.* The portion of the offsetable nonlife consolidated net operating loss or nonlife consolidated net capital loss that has not been used as a nonlife subgroup loss setoff against consolidated partial LICTI in the year it arose may be carried over to succeeding taxable years under the principles of §§ 1.1502-21 or 1.1502-21A (as appropriate) (relating to net operating loss deduction) or §§ 1.1502-22 or 1.1502-22A (as appropriate) (relating to net capital loss carryovers). However, in any particular succeeding year, the losses will be used under paragraph (h) of this section in computing nonlife consolidated taxable income before being

used in that year as a nonlife subgroup loss that sets off consolidated partial LICTI.

(3) *Nonlife subgroup loss rules and limitations.* The nonlife subgroup losses are subject to the following operating rules and limitations:

(i) *Separate return years.* The carryovers in paragraph (m)(2)(ii) of this section may include net operating losses and net capital losses of the nonlife members arising in separate return years ending after December 31, 1980, that may be carried over to a succeeding year under the principles (including limitations) of §§ 1.1502-21 and 1.1502-22 (or §§ 1.1502-21A and 1.1502-22A, as appropriate). But see subdivision (ix) of this paragraph (m)(3).

(ii) *Capital loss.* Nonlife consolidated net capital loss sets off consolidated partial LICTI only to the extent of life consolidated capital gain net income (as determined under paragraph (l)(4) of this section) and this setoff applies before any nonlife consolidated net operating loss sets off consolidated partial LICTI.

(iii) *Capital gain.* Life consolidated capital gain net income is zero in any taxable year in which the life subgroup has a consolidated LO and, in any taxable year, it may not exceed consolidated partial LICTI.

(iv) *Ordering rule.* Consolidated partial LICTI for a consolidated return year is set off by nonlife subgroup losses for that year before being set off (under paragraph (m)(2)(ii) of this section) by a carryover of a nonlife subgroup loss to that year.

(v) *Setoff at bottom line.* The setoff of nonlife subgroup losses against consolidated partial LICTI does not affect life member deductions that depend in whole or in part on GO or TII. Thus, the setoff does not affect the amount of consolidated partial LICTI (as determined under paragraph (j)

of this section) for any taxable year but it merely constitutes an adjustment in arriving at the group's consolidated taxable income under paragraph (g) of this section.

(vi) *Ineligible nonlife member.* (A) The offsetable nonlife consolidated net operating loss that arises in any consolidated return year (that may be set off against consolidated partial LICTI in the current taxable year or in a succeeding taxable year) is the amount computed under paragraph (h)(2)(ii) of this section reduced by the ineligible NOL. For purposes of this subparagraph (3), the "ineligible NOL" is in the year the loss arose the amount of the separate net operating loss (determined under § 1.1502-21(b)) of any nonlife member that is ineligible in that year (and not the portion of the nonlife consolidated net operating loss attributable under § 1.1502-21(b) to such a member). (B) The carryovers of offsetable nonlife net operating losses under paragraph (m)(2)(ii) of this section do not include an ineligible NOL arising in a consolidated return year or a loss attributable to an ineligible member arising in a separate return year. See section 1503(c)(2). (C) For absorption within the nonlife subgroup of an ineligible NOL arising in a consolidated return year or a loss of an ineligible member arising in a separate return year which is not a separate return limitation year under paragraph (m)(3)(ix) of this section, see paragraph (m)(3)(vii) of this section.

(vii) *Absorption of ineligible NOL.* (A) If all or a portion of a nonlife member's ineligible NOL (determined under paragraph (m)(3)(vi)(A) of this section) may be carried back or carried over under paragraph (h)(2) of this section to a particular consolidated return year of the nonlife subgroup (absorption year), then notwithstanding § 1.1502-21A(b)(3)(ii) or 1.1502-21(b), the amount carried to the absorption year will be absorbed by that member's contribution (to the extent thereof) to nonlife consolidated taxable income for that year.

(B) For purposes of (A) of this subdivision (vii), a member's contribution to nonlife consolidated taxable income

for an absorption year is the amount of such income (computed without the portion of the nonlife consolidated net operating loss deduction attributable to taxable years subsequent to the year the loss arose), minus such consolidated taxable income recomputed by excluding both that member's items of income and deductions for the absorption year. The deductions of the member include the prior application of this paragraph (m)(3)(vii) to the absorption of the nonlife consolidated net operating loss deduction for losses arising in taxable years prior to the particular loss year.

(viii) *Election to relinquish carryback.* The offsetable nonlife consolidated net operating loss does not include the amount that could be carried back under paragraph (h)(2) of this section but for the common parent's election under section 172(b)(3)(C) to relinquish the carryback. See section 1503(c)(1).

(ix) *Separate return limitation year.* The offsetable nonlife consolidated net operating and capital loss carryovers do not include any losses attributable to a nonlife member that were sustained (A) in a separate return limitation year (determined without section 1504(b)(2)) of that member (or a predecessor), or (B) in a separate return year ending after December 31, 1980, in which an election was in effect under neither section 1504(c)(2) nor section 243(b)(2). For purposes of this paragraph (m), a separate return limitation year includes a taxable year ending before January 1, 1981. See section 1507(c)(2)(A) of the Tax Reform Act of 1976 and §§ 1.1502-15 and 1.1502-15A (including applicable exceptions thereto).

(x) *Percentage limitation.* The offsetable nonlife consolidated net operating losses that may be set off against consolidated partial LICTI in a particular year may not exceed a percentage limitation. This limitation is the applicable percentage in section 1503(c)(1) of the lesser of two amounts.

The first amount is the sum of the offsetable nonlife consolidated net operating losses under paragraph (m)(2) of this section that may serve in the particular year (determined without this limitation) as a setoff against consolidated partial LICTI. The second amount is consolidated partial LICTI (as defined in paragraph (j) of this section) in the particular year reduced by any nonlife consolidated net capital loss that sets off consolidated partial LICTI in that year.

(xi) *Further limitation.* Any offsetable nonlife consolidated net operating loss remaining after applying the percentage limitation that is carried over to a succeeding taxable year may not be set off against the consolidated partial LICTI attributable to a life member that was not an eligible life member in the year the loss arose. See section 1503(c)(2).

(xii) *Restoration rule.* The carryback of a consolidated LO or life consolidated net capital loss under paragraph (l) of this section that reduces consolidated partial LICTI (or life consolidated capital gain net income) for a prior year may reduce the amount of nonlife subgroup losses that would offset consolidated partial LICTI in that prior year. Thus, that amount may be carried over under paragraph (h)(2) or (4) of this section from that prior year in determining nonlife consolidated taxable income in a succeeding year or serve as offsetable nonlife subgroup losses in a succeeding year.

(4) *Acquired groups.* [Reserved]

(5) *Illustrations.* The following examples illustrate this paragraph (m).

* * *

(n) ***Nonlife consolidated taxable income set off by life subgroup losses*** — (1) *In general.* The life subgroup losses consist of the consolidated LO and the life consolidated net capital loss (as determined under paragraph (l)(4) of this section). Under paragraph (g)(1) of this section, nonlife

consolidated taxable income is set off by the amounts of these two consolidated losses specified in paragraph (n)(2) of this section.

(2) *Amount of setoff.* The portion of the consolidated LO or life consolidated net capital loss that may be set off against nonlife consolidated taxable income (determined under paragraph (h) of this section) is d termined by applying the rules prescribed in paragraph (m)(2) and (3) of this section in the following manner:

(i) Substitute the term "life" for "nonlife", and vice versa.

(ii) Substitute the term "nonlife consolidated taxable income" for "consolidated partial LICTI", and vice versa.

(iii) Substitute the term "consolidated LO" for "non-life consolidated net operating loss", "paragraph (l)" or "paragraph (j)" for "paragraph (h)", and "section 812(b)(3)" for "section 172(b)(3)(C)".

(iv) Paragraphs (m)(3)(vi), (vii), (x), and (xi) of this section do not apply to a consolidated LO.

(v) Capital losses may not be deducted more than once. See section 818(e) and also the requirements in section 818(f).

(vi) The setoff of life subgroup losses against nonlife consolidated taxable income does not affect nonlife member deductions that depend in whole or in part on taxable income.

(3) *Illustrations.* The following examples illustrate this paragraph (n).

* * *

(o) ***Alternative tax*** — (1) *In general.* For purposes of the alternative tax under paragraph (f)(7)(ii) of this section, consolidated net capital gain is the sum of the following two amounts:

(i) The nonlife consolidated net capital gain reduced by any setoff of a life consolidated net capital loss.

(ii) The life consolidated net capital gain reduced by any setoff of a nonlife consolidated net capital loss.

(2) *Net capital gain.* For purposes of this paragraph (o):

(i) Nonlife consolidated net capital gain is computed under §§ 1.1502-41A or 1.1502-22T (as appropriate) except that it may not exceed nonlife consolidated taxable income (computed under paragraph (h) of this section).

(ii) Life consolidated net capital gain is computed under §§ 1.1502-41A or 1.1502-22T (as appropriate), applied in a manner consistent with paragraph (l)(4) of this section, except that it may not exceed consolidated partial LICTI (as determined under paragraph (j) of this section).

(iii) *Setoffs.* Setoffs are determined under paragraphs (m) or (n) of this section (as the case may be).

(p) ***Transitional rule for credit carryovers.*** For limitations on credits arising in taxable years ending before January 1, 1981, that may be carried over to taxable years beginning on or after that date, section 1507(c)(2)(A) of the Tax Reform Act of 1976 and the principles in paragraph (h)(3) of this section (relating to limitations on loss carryovers) apply.

(q) ***Preemption.*** The rules in this section preempt any inconsistent rules in other sections (§§ 1.1502-1 through 1.1502-80) of the consolidated return regulations. For example, the rules in paragraph (m)(3)(vi) apply notwithstanding §§ 1.1502-21A(b)(3) and 1.1502-79A(a)(3) (or § 1.1502-21, as appropriate).

(r) ***Other consolidation principles.*** The fact that this section treats the life and nonlife members as separate groups in computing, respectively, consolidated partial LICTI (or LO) and nonlife consolidated taxable income (or loss) does not

affect the usual rules in §§ 1.1502-0 — 1.1502-80 unless this section provides otherwise. Thus, the usual rules in § 1.1502-13 (relating to intercompany transactions) apply to both the life and nonlife members by treating them as members of one affiliated group.

(s) ***Filing requirements***. Nonlife consolidated taxable income or loss under paragraph (h) of this section shall be determined on a separate Form 1120 or 1120 M and consolidated partial LICTI under paragraph (j) of this section shall be determined on a separate Form 1120 L. The consolidated return shall be made on a separate Form 1120, 1120 M, or 1120 L by the common parent (if the group includes a life company), which shows the set-offs under paragraphs (g), (m), and (n) of this section and clearly indicates by notation on the face of the return that it is a life-nonlife consolidated return (if the group includes a life company). See also § 1.1502-75(j), relating to statements and schedules for subsidiaries.

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No. 99-258

In the Supreme Court of the United States

CONNECTICUT GENERAL LIFE INSURANCE COMPANY, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether Section 1.1502-47(m)(3)(vi) of the Treasury Regulations, 26 C.F.R. 1.1502-47(m)(3)(vi), prescribes the proper method for determining the amount of net operating losses of non-life insurance companies that may not be taken into account in determining taxable income on consolidated federal income tax returns that such companies file with life insurance companies.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	2
Argument	7
Conclusion	14

TABLE OF AUTHORITIES

Cases:

A.E. Staley Mfg. Co. v. *Commissioner*, 119 F.3d 482 (7th Cir. 1997)	13
Atlantic Mut. Ins. Co. v. *Commissioner*, 523 U.S. 382 (1998)	13
Auer v. *Robbins*, 519 U.S. 452 (1997)	11-12
Bowen v. *Georgetown Univ. Hosp.*, 488 U.S. 204 (1988)	12
Bowles v. *Seminole Rock & Sand Co.*, 325 U.S. 410 (1945)	11
Charles Ilfeld Co. v. *Hernandez*, 292 U.S. 62 (1934)	8
Chevron U.S.A. Inc. v. *Natural Resources Defense Council*, 467 U.S. 837 (1984)	10
Deputy v. *DuPont*, 308 U.S. 488 (1940)	13
Durando v. *United States*, 70 F.3d 548 (9th Cir. 1995)	13
Hassett v. *Welch*, 303 U.S. 303 (1938)	12
Helvering v. *Inter-Mountain Life Ins. Co.*, 294 U.S. 686 (1935)	14
INDOPCO, Inc. v. *Commissioner*, 503 U.S. 79 (1992)	13
Ladner v. *United States*, 358 U.S. 169 (1958)	13
Martin v. *Occupational Safety & Health Review Comm'n*, 499 U.S. 144 (1991)	12
National Muffler Dealers Ass'n v. *United States*, 440 U.S. 472 (1979)	13

Cases—Continued: Page

New Colonial Ice Co. v. *Helvering*, 292 U.S. 435 (1934) 13
Reno v. *Koray*, 515 U.S. 50 (1995) 13
Smith v. *United States*, 508 U.S. 223 (1993) 13
Thomas Jefferson Univ. v. *Shalala*, 512 U.S. 504 (1994) 12
UNUM Corp. v. *United States*, 130 F.3d 501 (1st Cir. 1997), cert. denied, 119 S. Ct. 42 (1998) 13
Weingarden v. *Commissioner*, 825 F.2d 1027 (6th Cir. 1987) 13
White v. *United States*, 305 U.S. 281 (1938) 12, 14

Statutes and regulations:

Internal Revenue Code (26 U.S.C.):
§ 1501 7
§ 1502 8
§ 1503(c) 2
§ 1503(c)(2) 2, 4, 5, 7, 8
Tax Reform Act of 1976, Pub. L. No. 94-455, § 1507, 90 Stat. 1739-1741 2
26 C.F.R.:
Section 1.1502-47 7
Section 1.1502-47(d)(12) 3
Section 1.1502-47(d)(13) 3
Section 1.1502-47(h)(2)(ii) 2
Section 1.1502-47(i) 9
Section 1.1502.47(j) 9
Section 1.1502.47(k)(1) –(k)(4) 9
Section 1.1502.47(*l*)(1) 9
Section 1.1502.47(*l*)(2) 9
Section 1.1502-47(m)(3)(vi) 3, 5, 6, 7, 11
Section 1.1502-47(m)(4) 6, 7, 9
Section 1.1502-75(d)(3) 3

Miscellaneous:

S. Rep. No. 938, 94th Cong., 2d. Sess. (1976) 8
S. Rep. No. 960, 70th Cong., 1st Sess. (1928) 8

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-23a) is reported at 177 F.3d 136. The opinion of the Tax Court (Pet. App. 24a-38a) is reported at 109 T.C. 100.

JURISDICTION

The judgment of the court of appeals was entered on April 30, 1999. On July 20, 1999, Justice Souter extended the time for filing a petition for a writ of certiorari to August 12, 1999. The petition was filed on August 12, 1999. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Prior to 1981, life insurance companies were not permitted to file consolidated federal income tax returns with corporations that were not life insurance companies. For tax years beginning after December 31, 1980, Congress changed this rule, and permitted "life-nonlife consolidation."[1] In Section 1503(c) of the Internal Revenue Code, 26 U.S.C. 1503(c), however, Congress placed two limitations on the extent to which the net operating losses (NOLs) of nonlife companies may be used to reduce the taxable income reported on the consolidated return. One of those limitations, set forth in Section 1503(c)(2), is that an NOL of a nonlife company "shall not be taken into account" in determining the taxable income of the affiliated group unless the nonlife company has been a member of the group for the five years preceding the year the loss was incurred.

Regulations promulgated by the Secretary of the Treasury prescribe the method for determining the NOLs that, under Section 1503(c)(2), "shall not be taken into account." As pertinent here, the regulations require all nonlife companies within the group to set off their gains and losses against each other, and thereby determine whether the "nonlife subgroup" had a consolidated net operating loss (CNOL). 26 C.F.R. 1.1502-47(h)(2)(ii). The amount of the CNOL that could be used to offset the income of life companies in the group was to be "reduced by the ineligible NOL," *i.e.*, "the amount of the *separate* net operating loss * * * of any

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[1] Tax Reform Act of 1976, Pub. L. No. 94-455, § 1507, 90 Stat. 1739-1741.

nonlife *member* that is ineligible in that year."[2] 26 C.F.R. 1.1502-47(m)(3)(vi) (emphasis added).

2. Before March 31, 1982, Connecticut General Corporation was the parent corporation of Connecticut General Life Insurance Company (CG Life) and more than 40 other corporations. CG Life was the sole life insurance company in this group. Pursuant to the new rules permitting life-nonlife consolidation, CG Life joined with the other subsidiaries of Connecticut General Corporation in the filing of consolidated federal income tax returns for the period ending March 31, 1982 (Pet. App. 3a, 25a).

Prior to March 31, 1982, INA Corporation was the common parent of more than 160 affiliated non-life corporations that engaged primarily in the sale, underwriting, and servicing of property and casualty insurance. INA Corporation had filed consolidated federal income tax returns on behalf of itself and its subsidiaries (Pet. App. 4a). On March 31, 1982, Connecticut General Corporation and INA Corporation (the two parent companies) merged to form CIGNA Corporation. The merger was a "reverse acquisition" within the meaning of 26 C.F.R. 1.1502-75(d)(3), pursuant to which CIGNA succeeded Connecticut General as the common parent of the CG group, which continued to exist for tax purposes. CIGNA also became the common parent of each of the former members of the INA group, which group ceased to exist for tax

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[2] The regulations define an "ineligible" corporation as a corporation that is not eligible. 26 C.F.R. 1.1502-47(d)(13). An "eligible" corporation is defined, in part, as a corporation that has been a member of the affiliated group for at least five years preceding the taxable year for which the consolidated return and the determination of eligibility are made. 26 C.F.R. 1.1502-47(d)(12).

purposes. Thus, in effect, the CG group, which became the CIGNA group, acquired the former INA subsidiaries individually.

On November 20, 1984, a subsidiary of CIGNA acquired Preferred Health Care, Inc. (PHC) and its affiliated corporations, none of which were life insurance companies. Before the acquisition, the PHC group had filed consolidated federal income tax returns. All members of the PHC group immediately before the acquisition became separate members of the CIGNA group upon the acquisition, and the PHC group ceased to exist (Pet. App. 4a).

3. The consolidated federal income tax returns filed by CIGNA for 1982 through 1985 included the corporations that had been members of the former INA group, and the returns filed for 1984 and 1985 included the corporations that had been members of the former PHC group. CG Life was the only life insurance company included in these consolidated returns, and it had taxable income during each of these taxable periods. Some of the corporations that had formerly been members of the INA group and the PHC group had taxable income during these years, and others had tax losses (Pet. App. 7a).

In calculating the amount of the NOLs for the 1982 through 1985 consolidated returns that, under Section 1503(c)(2), "shall not be taken into account," CIGNA treated all corporations that were formerly members of the INA group as a single entity. Under this "single entity method," petitioners set off the losses of those former INA corporations that had losses against the income of those that had income. The result was a net loss for each taxable period. Petitioners did the same with respect to the former PHC companies, and the result was a net loss for the 1985 taxable year. It was

the resulting net losses calculated in this manner that CIGNA treated as the NOLs that "shall not be taken into account" under Section 1503(c)(2) (Pet. App. 7a-8a).

4. On audit, the Commissioner determined that CIGNA used an incorrect method to calculate the NOLs that shall not be taken into account. The Commissioner concluded that Section 1.1502-47(m)(3)(vi) of the Treasury Regulations does not permit CIGNA to treat all former members of the INA group as a single entity, and all former members of the PHC group as a single entity. The Commissioner determined that the regulation instead requires CIGNA to treat each corporation that had formerly been in the INA group and the PHC group as a separate member of the newly-constituted CIGNA group. Under this "separate entity method," the entire NOL of each corporation that had formerly been in the INA group and the PHC group is ineligible and is therefore to be disregarded (Pet. App. 8a-9a). Under this method, these NOLs are not to be "taken into account" at any time in the calculation of the taxable income reported on the consolidated returns.

5. Petitioners filed a petition in the Tax Court to challenge the Commissioner's determination. On cross-motions for summary judgment, the Tax Court ruled in favor of the Commissioner. The court observed that the regulations adopted under Section 1503(c)(2) are substantive legislative rules which require "each nonlife company that constitutes a member of the consolidated group [to be] treated as a separate entity" (Pet. App. 32a). It follows, the court said, that the consolidated NOL of all of the nonlife companies included in the consolidated federal income tax return "is reduced by the separate 'ineligible NOL' of each ineligible nonlife company that constitutes a member of the consolidated group" (*ibid.*). The court emphasized that (*id.* at 33a):

> [n]o provision is made in the above legislative regulations to treat a company that prior to acquisition had been a member of a group that had filed a consolidated income tax return as part of a single, aggregate group of companies and to net within that group losses of ineligible nonlife companies against income of other nonlife companies of the same acquired group.

6. Concluding "that the applicable Treasury regulation, as interpreted by the Commissioner, is a permissible interpretation of the statute" (Pet. App. 1a-2a), the court of appeals affirmed. The court of appeals first rejected petitioners' primary contention that the regulation is not even applicable to this case. Petitioners had claimed that the regulation applies only to acquired stand-alone corporations and not to acquired groups, such as its acquisitions of the INA corporations and the PHC corporations. In support of their argument, petitioners relied primarily on Section 1.1502-47(m)(4) of the Treasury Regulations which reads, in its entirety, "*Acquired Groups.* [Reserved]." 26 C.F.R. 1.1502-47(m)(4). Petitioners argued that this reserved section in the regulations shows that the Commissioner intended to except acquired groups from the general rule of Section 1.1502-47(m)(3)(vi). Petitioners argued that, in the absence of any specific rule applicable to acquired groups, they were entitled to use any reasonable means to calculate the amount of their ineligible NOLs.

The court of appeals concluded, however, that the Commissioner's interpretation of the Treasury Regulations to apply in this situation is entitled to deference. The court found that "nothing in Regulation [1.1502]-47(m)(4) contradicts the Commissioner's interpretation

of Regulation [1.1502]-47(m)(3)(vi) as applying to acquired groups." Because Regulation 1.1502-47(m)(3)(vi) makes no distinction between acquired stand-alone companies and acquired groups and, "by its own terms, applies to" the facts of this case (Pet. App. 17a-18a), the court of appeals concluded that it was proper to defer to the interpretation of the regulation by the agency that Congress charged with the enforcement of the statute and the adoption of the legislative rule (*id.* at 12a-14a, 18a).[3]

ARGUMENT

The court of appeals held that petitioners must calculate the NOLs of their affiliates that "shall not be taken into account" (26 U.S.C. 1503(c)(2)) in determining taxable income on their consolidated federal income tax returns in the manner prescribed by Section 1.1502-47(m)(3)(vi) of the Regulations. This holding is correct and does not conflict with any decision of this Court or any other court of appeals. Indeed, the issue has never been addressed by this Court or any other court of appeals. Further review is therefore not warranted.

1. Section 1501 of the Internal Revenue Code, 26 U.S.C. 1501, grants affiliated groups of corporations the "privilege" of filing consolidated federal income tax returns. The privilege is available, however, only when each corporation in the affiliated group consents to all

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[3] The court of appeals also rejected petitioners' contention that the preamble to the Section 1.1502-47 regulations supports their argument that no rule was promulgated with respect to acquired groups. The court observed that the preamble "suggests that applying a rule other than that annunciated in [1.1502]-47(m)(3)(vi) would contradict 'the ordinary reading of section 1503(c)(2)' " of the Code (Pet. App. 17a).

consolidated return regulations issued by the Secretary of the Treasury. See *Charles Ilfeld Co.* v. *Hernandez*, 292 U.S. 62, 65 (1934). Congress did not set forth detailed rules in the statute prescribing how the consolidated taxable income of an affiliated group of corporations is to be determined. In Section 1502 of the Code, Congress charged the Secretary with prescribing "such regulations as he may deem necessary" to ensure that the tax liability of an affiliated group of corporations is properly determined. 26 U.S.C. 1502. See S. Rep. No. 960, 70th Cong., 1st Sess. 15 (1928) ("delegat[ing] power to the commissioner to prescribe regulations legislative in character").

When Congress enacted the statutory provisions permitting life-nonlife consolidation, it did not prescribe detailed rules on how the group's income was to be determined. As pertinent here, the only rule it provided was that the NOL of a nonlife member of the group "shall not be taken into account in determining the taxable income" of a life insurance company in the group unless the life and nonlife members have been in the same affiliated group for at least five years. 26 U.S.C. 1503(c)(2). The report of the Senate Finance Committee emphasized that, under this statute, "the details of the computation of the tax liability of an affiliated group which includes life or other mutual insurance companies is to be determined under regulations issued by the Treasury Department". S. Rep. No. 938, 94th Cong., 2d Sess. 456 (1976).

2. On June 8, 1982, the Secretary issued proposed regulations prescribing rules for filing life-nonlife consolidated returns (Pet. App. 4a). The proposed regulations made no distinction between acquired stand-alone companies and acquired groups. After the proposed regulations were issued, CIGNA wrote to the Com-

missioner suggesting that the Secretary adopt by regulation a special rule for acquired groups such as the one that petitioners have advocated in this lawsuit—that "separate nonlife members be treated as one entity if they are acquired in a single transaction by one group but were members of a different group prior to their acquisition" (*id.* at 5a). When the final regulations were ultimately issued, however, they did not include a special rule for acquired groups. In a letter sent to CIGNA after the final regulations were issued, the Chief Counsel of the IRS, Kenneth W. Gideon, specifically informed CIGNA that the "final life-nonlife consolidated return regulations * * * do not adopt your suggestion" (*id.* at 6a).

The final regulations differed from the proposed regulations by adding the "reserved" paragraph at Section 1.1502-47(m)(4).[4] The preamble to the final regulations states that "notwithstanding the ordinary reading of section 1503(c)(2) [of the Code]," the Treasury Department intended to study further whether to adopt an exception from the rule such as the one that CIGNA had proposed. The preamble stated that the agency would consider whether it would "be consistent with the intent of section 1503(c)(2), or correct as a matter of policy," to adopt a rule such as the one suggested by CIGNA (Pet. App. 6a).

Internal Treasury and Internal Revenue Service memoranda that petitioners relied upon below (C.A. App. 199-216) show that during the three year period after the issuance of the final regulations, the Treasury

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[4] The "reservation" of a paragraph of the regulations is not unique to Section 1.1502-47(m)(4). For example, eight other paragraphs or subparagraphs of Section 1.1502-47 alone are marked "reserved." See 26 C.F.R. 1.1502-47(i), (j), (k)(1)-(k)(4), (*l*)(1), (*l*)(2).

did, in fact, study the possibility of issuing a special rule for "acquired groups" similar to the rule suggested by CIGNA. These memoranda discuss the advantages and disadvantages of such a rule, and reveal that there were differences of opinion within the Treasury and IRS as to whether a special rule for acquired groups would be appropriate. Despite this lengthy and in-depth study of the CIGNA proposal, however, the agency has declined to promulgate the special rule for acquired groups sought by petitioners.

The internal Treasury and IRS memoranda that CIGNA relied upon repeatedly refer to the issue raised in this case as the "CIGNA issue" (C. A. App. 199, 201, 204, 215). Despite its vigorous efforts before the agency, CIGNA never succeeded in persuading the Treasury to adopt the rule it advocated. Undeterred, CIGNA has decided in this lawsuit to "wag[e] in a judicial forum a specific policy battle which [it] ultimately lost in the agency." *Chevron U.S.A Inc.* v. *Natural Resources Defense Council*, 467 U.S. 837, 864 (1984). This battle is misguided. "When a challenge to an agency construction of a statutory provision, fairly conceptualized, really centers on the wisdom of the agency's policy, rather than whether it is a reasonable choice within a gap left open by Congress, the challenge must fail." *Id.* at 866.

3. The NOLs involved in this case were incurred by members of the former INA group *after* the merger. Because these losses took place *after* the merger, they could not be considered losses of the INA group, which ceased to exist upon the merger. The losses were, instead, losses of separate members of the newly-constituted CIGNA group. Because the former members of the INA group had been members of the CIGNA group for less than five years, they were

"ineligible" corporations and, under the plain language of Treasury Regulation 1.1502-47(m)(3)(vi), their *separate* NOLs therefore had to be subtracted from the nonlife consolidated NOL to determine the "offsetable nonlife consolidated net operating loss." 26 C.F.R. 1.1502-47(m)(3)(vi).

Petitioners' primary contention is that the court of appeals erred in deferring to the Commissioner's interpretation of the straightforward text of the regulations. Although petitioners purport to acknowledge the settled rule that courts are to defer to an agency's interpretation of its own regulations, see *Bowles* v. *Seminole Rock & Sand Co.*, 325 U.S. 410, 413-414 (1945), they assert that the agency's interpretation is not entitled to deference when it is first advanced in litigation. That contention, however, is based on a false premise. Contrary to petitioners' assumption, the position advanced by the Commissioner in this case—that the ineligible NOLs had to be calculated under Regulation 1.1502-47(m)(3)(vi)—was unquestionably not the invention of the IRS counsel who represented the Commissioner in the Tax Court. As we have just described, the Treasury determined at the time that it issued the final regulations *not* to adopt the special "CIGNA rule" espoused by petitioners. Moreover, although the Treasury and the Internal Revenue Service further studied the "CIGNA issue" for several years after the final regulations were issued, the special rule espoused by petitioners has not been adopted. In these circumstances, the agency's announced interpretation of its own legislative regulations plainly "reflect[s] the agency's fair and considered judgment on the matter in question" and was properly accorded deference by the court of appeals. *Auer* v. *Robbins*, 519

U.S. 452, 462 (1997).[5] See also *Thomas Jefferson Univ.* v. *Shalala*, 512 U.S. 504, 512 (1994).

Moreover, as the court of appeals emphasized (Pet. App. 8a-9a), the interpretation of the regulation advanced by the Commissioner in this litigation is precisely the same that the agency has asserted throughout the lengthy audit of petitioners' consolidated returns. This Court has consistently concluded that an agency's interpretation of its regulations is entitled to deference even if the interpretation is first adopted during administrative proceedings. As the Court stated in *Martin* v. *Occupational Safety and Health Review Commission*, 499 U.S. 144, 158 (1991), "the Secretary's interpretation is not undeserving of deference merely because the Secretary advances it for the first time in an administrative adjudication."

4. Petitioners err in contending (Pet. 21) that the decision of the court of appeals conflicts with decisions holding that the rule of lenity may require ambiguous tax provisions to be construed in favor of the taxpayer. The most recent of the decisions of this Court cited by petitioners for this proposition is *Hassett* v. *Welch*, 303 U.S. 303, 314 (1938). In the subsequent decision of *White* v. *United States*, 305 U.S. 281, 292 (1938), however, the Court stated:[6]

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[5] In this case, as in *Auer* v. *Robbins*, *supra*, the Commissioner's position "is in no sense a '*post hoc* rationalizatio[n]' advanced by an agency seeking to defend past agency action against attack." 519 U.S. at 462. Contrary to petitioners' unsupported assertion (Pet. 20), the decision in this case thus does not "threaten[] to eviscerate" this Court's decision in *Bowen* v. *Georgetown University Hospital*, 488 U.S. 204 (1988).

[6] Petitioners also err in their understanding of how the rule of lenity applies to the interpretation of ambiguous statutes. "The rule of lenity applies only if, 'after seizing everything from which

> We are not impressed by the argument that, as the question here decided is doubtful, all doubts should be resolved in favor of the taxpayer. It is the function and duty of courts to resolve doubts. We know of no reason why that function should be abdicated in a tax case more than in any other where the rights of suitors turn on the construction of a statute and it is our duty to decide what that construction fairly should be.

It is, in any event, an elementary rule in tax law that deductions from income are matters of legislative grace that must be "strictly construed and allowed only 'as there is a clear provision therefor.'" *INDOPCO, Inc.* v. *Commissioner*, 503 U.S. 79, 84 (1992), quoting *New Colonial Ice Co.* v. *Helvering*, 292 U.S. 435, 440 (1934). See also *Deputy* v. *DuPont*, 308 U.S. 488, 493 (1940); *A.E. Staley Mfg. Co.* v. *Commissioner*, 119 F.3d 482, 486 (7th Cir. 1997) (deductions from income are "strictly construed"); *UNUM Corp.* v. *United States*, 130 F.3d 501, 509 (1st Cir. 1997) (same), cert. denied, 119 S. Ct. 42 (1998); *Durando* v. *United States*, 70 F.3d 548, 550 (9th Cir. 1995) (same); *Weingarden* v. *Commissioner*, 825 F.2d 1027, 1029 (6th Cir. 1987) (same). Because the

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aid can be derived,' *Smith* v. *United States*, 508 U.S. 223, 239 (1993) (internal quotation marks and brackets omitted), we can make 'no more than a guess as to what Congress intended.' *Ladner* v. *United States*, 358 U.S. 169, 178 (1958)." *Reno* v. *Koray*, 515 U.S. 50, 64-65 (1995). One of the principles "from which aid can be derived" in the interpretation of statutes and legislative regulations is the principle that deference is to be given to reasonable interpretations adopted by the Treasury—the agency that Congress has charged with enforcement of these complex provisions. See, *e.g.*, *Atlantic Mut. Ins. Co.* v. *Commissioner*, 523 U.S. 382, 389-390 (1998); *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 477 (1979).

statutory and regulatory provisions that govern this case allow deductions from income that would otherwise be subject to tax, they are to be strictly construed. The Court long made clear, even prior to its decision in *White* v. *United States*, *supra*, that, in a deduction case, "[t]he rule that ambiguities in statutes imposing taxes are to be resolved in favor of taxpayers does not apply. Deductions are allowed only when plainly authorized." *Helvering* v. *Inter-Mountain Life Ins. Co.*, 294 U.S. 686, 689 (1935).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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No. 99-258

IN THE
Supreme Court of the United States

CONNECTICUT GENERAL LIFE INSURANCE COMPANY, *et al.*,
Petitioners,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF *AMICI CURIAE* OF THE AMERICAN COUNCIL OF LIFE INSURANCE, THE CHAMBER OF COMMERCE OF THE UNITED STATES, THE FINANCIAL EXECUTIVES INSTITUTE, MERCK & CO., INC., THE NATIONAL ASSOCIATION OF MANUFACTURERS, THE PRUDENTIAL INSURANCE COMPANY OF AMERICA, THE REAL ESTATE ROUNDTABLE, THE SECURITIES INDUSTRY ASSOCIATION, SUNOCO INC., THE TAX COUNCIL, THE TAX FOUNDATION, AND THE UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS IN SUPPORT OF PETITIONERS

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21pp

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	iii
INTEREST OF THE *AMICI CURIAE*	1
REASONS FOR GRANTING THE WRIT	5
I. THE DOCTRINAL CONFLICT IN THE CIRCUITS WARRANTS IMMEDIATE REVIEW BY THIS COURT	5
II. THE DECISION BELOW TO ACCORD DEFERENCE TO A MERE IRS LITIGATING POSITION INTERPRETING AN AMBIGUOUS TREASURY REGULATION IS INCONSISTENT WITH PROVISIONS OF THE INTERNAL REVENUE CODE THAT ACCORD NO DEFERENCE TO THE MORE DELIBERATIVE LEGAL CONCLUSIONS OF THE TAX COURT AND TO WRITTEN DETERMINATIONS OF THE IRS	8
A. The Third Circuit Would Accord Greater Deference to an IRS Litigating Position Interpreting an Ambiguous Treasury Regulation Than It Is Permitted By Statute to Give to a Legal Conclusion of the Tax Court	9
B. The Third Circuit Would Accord Greater Deference to an IRS Litigating Position Interpreting an Ambiguous Treasury Regulation Than It Is Permitted by Statute to Give to a "Written Determination" of the IRS	10
III. THE INTERNAL REVENUE CODE DOES NOT PROVIDE FOR OR REQUIRE DEFERENCE TO AN IRS LITIGATING POSITION INTERPRETING AN AMBIGUOUS TREASURY REGULATION, AND IT IS IMPROPER TO ACCORD DEFERENCE TO SUCH A POSITION	12

TABLE OF CONTENTS—Continued

Page

IV. THE RULE ADOPTED BY THE THIRD CIRCUIT IS A SERIOUS THREAT TO PROPER TAX ADMINISTRATION 14

CONCLUSION 17

TABLE OF AUTHORITIES

CASES Page

AMP, Inc. v. United States, 99-2 USTC ¶ 50, 1999 U.S. App. LEXIS 18022 (Fed. Cir. 1999) 6, 7
Brewster v. Sullivan, 972 F.2d 898 (8th Cir. 1992) 6
CSI Hydrostatic Testers, Inc. v. Commissioner, 62 F.3d 136 (5th Cir. 1995) 6
Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984) 12
Commissioner v. Lester, 366 U.S. 299 (1961) 15
Commissioner v. Tellier, 383 U.S. 690 (1966) 13
Cottage Sav. Ass'n v. Commissioner, 499 U.S. 554 (1991) 14
Dobson v. Commissioner, 320 U.S. 489 (1943) 9
Elder v. Holloway, 510 U.S. 510 (1994) 10
First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938 (1995) 10
Harco Holdings, Inc. v. United States, 977 F.2d 1027 (7th Cir. 1992) 6
Longhi v. Animal & Plant Health Inspection Serv., 165 F.3d 1057 (6th Cir. 1999) 6
National Muffler Dealers Ass'n v. United States, 440 U.S. 472 (1979) 12
Ornelas v. United States, 517 U.S. 690 (1996) 10
Pierce v. Underwood, 487 U.S. 552 (1988) 10
Public Citizen v. Carlin, 184 F.3d 900 (D.C. Cir. 1999) 6
Rowan Cos. v. United States, 452 U.S. 247 (1981) 11
Smiley v. Citibank (S.D.), N.A., 517 U.S. 735 (1996) 12
United States v. Cartwright, 411 U.S. 546 (1973) 15
United States v. Davis, 397 U.S. 301 (1970) 16
United States v. Trident Seafoods Corp., 60 F.3d 556 (9th Cir. 1995) 6
William Bros., Inc. v. Pate, 833 F.2d 261 (11th Cir. 1987) 6

TABLE OF AUTHORITIES—Continued

STATUTES AND REGULATIONS	Page
5 U.S.C. § 553	13
26 U.S.C. § 501(c)(3)	5
26 U.S.C. § 6110(k)(3)	10
26 U.S.C. § 6213(a)	4
26 U.S.C. § 7805(a)	12
26 U.S.C. § 7482	4, 9, 10
28 U.S.C. § 1294(1)	4
28 U.S.C. § 1205(a)(3)	5
28 U.S.C. § 1346(a)(1)	4
Treas. Reg. § 301.6110-2(a), (d), (e), (f)	10-11
Treas. Reg. § 1.170A-1(C)	15
Treas. Reg. § 1.302-1	16
Treas. Reg. § 1.1502-47(m)(3)(vi), (4)	4
Treas. Reg. § 601.601	13
Treas. Reg. § 20.2031	15
Treas. Reg. § 20.2032	15
Temp. Treas. Reg. § 1.71-1T A-14, A-17	15
93 Cong. Rec. A3281 (1948) (statement of Rep. Hobbs)	9
94 Cong. Rec. 8500, 8500-01 (1948) (statements of Rep. Reed and Committee on the Judiciary)	9
Pub. L. No. 80-773, 62 Stat. 869 (1948), *reprinted in* 1 U.S.C.C.A.N. A1	9
S. Rep. No. 80-1559, at 13 (1948)	9

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INTEREST OF THE *AMICI CURIAE*

Amici include voluntary business and professional associations representing a broad spectrum of industry and related interests which are affected, either directly or through their members or contributors, by the decision of the Third Circuit below.[1] *Amici* also include individual

[1] This brief was not authored in whole or in part by counsel for a party to this proceeding, and no person or entity, other than the

corporations that are adversely affected by the Third Circuit's decision and a nonprofit independent research and educational organization. Both the associations and the other *amici* are also concerned about the extraordinarily broad implications of that decision. While this case is a federal income tax case, there should be no misunderstanding about its scope: Under the rule adopted by the Third Circuit, deference must be accorded not only to an Internal Revenue Service("IRS") litigating position interpreting an ambiguous Treasury regulation, but to the litigating position of *any* federal agency interpreting *any* ambiguous federal regulation. The position of the *amici*, to the contrary, is that no deference is due to a mere litigating position of a federal agency, expressed through its counsel in an adversarial proceeding, interpreting an ambiguous regulation.

The Chamber of Commerce of the United States of America is the world's largest business federation representing an underlying membership of more than three million businesses and organizations of every size, in every sector and region of the country. The Financial Executives Institute is a professional association representing over 14,000 senior corporate financial officers in over 8,000 corporations throughout the United States and Canada. The National Association of Manufacturers is the nation's oldest and largest broad-based industrial trade association. Its nearly 14,000 member companies and subsidiaries, including 10,000 small manufacturers, employ approximately 85 percent of all manufacturing work-

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amici curiae, made a monetary contribution to the preparation or submission of this brief. All parties have consented to the submission of this brief in letters of consent filed with the Clerk of the Court.

ers and produce over 80 percent of the nation's manufactured goods. Members of the Real Estate Roundtable include individuals who represent or are employed by a wide range of organizations with real estate interests: real estate investment trusts, private real estate companies, lending institutions, investment bankers, property management companies and developers. Member firms of the Securities Industry Association include more than 740 investment banks, broker-dealers, and mutual fund companies which collectively manage the accounts of more than 50 million investors directly and tens of millions of investors indirectly through corporate, thrift, and pension plans. The Tax Council is a nonprofit organization with 110 members that are among the most prominent corporations, businesses and organizations in the nation, including 25 of the 50 largest corporations in the United States. The United States Council for International Business promotes the global interests of American business at home and abroad by representing U.S. business positions both in intergovernmental bodies and in direct dealings with foreign businesses and foreign governments.

The members of the foregoing association *amici*, or the organizations represented by members, are subject to federal tax regulations and to other federal regulations of virtually every description. The regulations run the gamut of federal authority and touch upon significant interests of these *amici* in their myriad activities. Many of the regulations are ambiguous. Accordingly, these *amici* have a profound interest in the decision of the Third Circuit below and in this Court's disposition of the case.

The American Council of Life Insurance ("ACLI") is the largest life insurance trade association in the United States, representing the interests of 493 member life insurance companies. ACLI members hold 77.3% of the life insurance written nationwide. Based on a review of

the corporate structures of its member companies and the life and nonlife insurance operations of these companies and their affiliates, the ACLI believes that the precise tax issue raised in the present case could potentially arise in a significant number of cases involving ACLI members.

The Prudential Insurance Company of America is a member of ACLI and one of the nation's largest life insurance companies. Prudential is also the common parent corporation of an affliated group of nonlife companies. Prior to their acquisition by Prudential, those nonlife affiliates that suffered losses were allowed to offset those nonlife losses against the nonlife income of other profitable affiliates. As a result of the acquisition of these nonlife affiliates by Prudential, however, the Commissioner has taken the position, in reliance on the same regulations[2] that the Third Circuit found ambiguous in the instant case (Pet. App. 15a-17a), that such offsetting is no longer permissible. In short, the substantive tax issue raised in Prudential's case is identical to that presented by the petitioners here.

Prudential, moreover, is a New Jersey corporation with its principal place of business in Newark. Thus, if Prudential were to proceed in the Tax Court (*see* 26 U.S.C. § 6213(a)) or in the United States District Court for the District of New Jersey (*see* 28 U.S.C. § 1346(a)(1) (1994)), venue for its appeal would be proper in the Third Circuit (*see* 26 U.S.C. § 7482(b)(1)(B), 28 U.S.C. § 1294(1) (1994)), and the decision below presumably would be controlling in Prudential's case if this Court were to deny the petition in this case. Prudential would also have the option, as all taxpayers do, to bring a refund suit in the United States Court of Federal Claims (*see* 28 U.S.C. § 1346(a)(1) (1994)), from which an

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[2] *See* Treas. Reg. § 1.1502-47(m)(3)(vi), (4) (*codified at* 26 C.F.R. § 1.1502-47(m)(3)(vi), (4)).

appeal would lie to the Federal Circuit (*see* 28 U.S.C. § 1205(a)(3) (1994)). Nevertheless, its Tax Court and district court options will, as a practical matter, be foreclosed if the decision below is permitted to stand.

Merck & Co., Inc. is one of the country's leading manufacturers and distributors of prescription and over-the-counter drugs. Sunoco, Inc. is one of the largest independent petroleum refiner-marketers in the United States. Like Prudential, Merck and Sunoco are subject to the appellate jurisdiction of the Third Circuit in tax cases and thus are adversely affected by the decision below.

The Tax Foundation is a nonprofit, non-partisan public policy research and educational organization whose mission is to provide the public and policymakers with reliable, credible information and analysis in the belief that this will result in better public policies. As a tax-exempt organization under section 501(c)(3) of the Internal Revenue Code of 1986 (the "Code") (26 U.S.C. § 501 (c)(3)), the Tax Foundation relies entirely on voluntary contributions from philanthropic foundations, businesses, and individuals across the country. The Tax Foundation believes that the issue raised here is of great public importance and should be resolved promptly by this Court.

REASONS FOR GRANTING THE WRIT

I. THE DOCTRINAL CONFLICT IN THE CIRCUITS WARRANTS IMMEDIATE REVIEW BY THIS COURT

The petition clearly demonstrates (pp. 9-11) the doctrinal conflict between the decision of the Third Circuit below and decisions of the Fifth, Sixth, Seventh, Eighth, Ninth, Eleventh, and Federal Circuits, in which those courts declined to give deference to an agency litigating

position interpreting an ambiguous regulation.[3] While none of the cases arising outside the Third Circuit involved the life/nonlife consolidated return regulations, and some of those cases involved nontax issues, this case nonetheless is ripe for immediate review by this Court for several reasons.

First, as evidenced by the number of circuit court cases that have involved the generic issue of deference to an agency interpretation of an ambiguous regulation—asserted only in litigation—the issue is a recurring and pervasive one of administrative law. It is not limited to the interpretation of the consolidated return regulations in dispute here. Nor is it limited to the interpretation of Treasury regulations. Rather, it applies to the interpretation of regulations promulgated by all federal agencies, with special applicability to tax regulations because of their volume and complexity. Thus, a multi-circuit doctrinal conflict presently exists in the courts of appeals.

Second, in light of the number of circuits that have already addressed the issue, there is far less promise than usual that additional consideration by the courts of appeals will elucidate the issue further or otherwise aid the Court in its ultimate disposition of the matter. The issue

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[3] *See CSI Hydrostatic Testers, Inc. v. Commissioner*, 62 F.3d 136 (5th Cir. 1995) (*per curiam*); *Longhi v. Animal & Plant Health Inspection Serv.*, 165 F.3d 1057 (6th Cir. 1999); *Harco Holdings, Inc. v. United States*, 977 F.2d 1027 (7th Cir. 1992); *Brewster v. Sullivan*, 972 F.2d 898 (8th Cir. 1992); *United States v. Trident Seafoods Corp.*, 60 F.3d 556 (9th Cir. 1995); *William Bros., Inc. v. Pate*, 833 F.2d 261 (11th Cir. 1987); *AMP, Inc. v. United States*, 99-2 U.S.T.C. ¶ 50, 728, 1999 U.S. App. LEXIS 18022 (Fed. Cir. 1999). The District of Columbia Circuit has also recently addressed this issue, holding that deference was due to the litigating position of the archivist of the United States interpreting his own ambiguous regulation. *Public Citizen v. Carlin*, 184 F.3d 900 (D.C. Cir. 1999).

is appropriate for review now, and nothing is to be gained by postponing this Court's consideration of the important question presented.

Third, as evidenced by the large number of participating *amici* and the varied interests they represent, the issue raised here is one of great breadth and overarching importance. To the extent that corporate *amici* or members of association *amici* are subject to the appellate jurisdiction of the Third Circuit, the adverse implications of the decision below are obvious. Members of association *amici* that are subject to the jurisdiction of other courts of appeals, *i.e.*, those that have resolved the issue differently from the Third Circuit and those that have not yet addressed the issue, are also disadvantaged by the uncertainty resulting from the multi-circuit split that presently exists. Only this Court can eliminate that uncertainty and ensure a uniform rule for all parties.

What is specifically at stake here is the balance of litigating power between taxpayer and tax collector in a large number of tax cases—those involving the proper interpretation of ambiguous Treasury regulations—and, more generally, between the regulator and the regulated in all areas in which federal regulatory power is exercised and the government's regulation is ambiguous. This is a fundamental issue that is worthy of this Court's consideration.

Finally, it is particularly significant that the Federal Circuit has recently spoken on the issue and indicated that it would not defer to an IRS revenue ruling issued in anticipation of litigation which interpreted an ambiguous tax regulation.[4] From this it would follow, *a fortiori*, that the Federal Circuit would not defer to a litigating

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[4] *See AMP Inc.*, 1999 U.S. App. LEXIS 18022, at *13 n.3.

position of the IRS interpreting an ambiguous tax regulation where the litigating position was not even embodied in a revenue ruling or other announcement or decision of the National Office of the IRS. As discussed above (pp. 4-5), *amicus* Prudential will not litigate in the Tax Court or the district court if this Court declines review here, but rather will bring a refund suit in the Claims Court, the appeal of which will be heard in the Federal Circuit. It thus appears that a conflict will arise between the Third and Federal Circuits on the deference due to an IRS interpertation of the very consolidated return regulations that are here in dispute. Accordingly, the present case is a particularly appropriate vehicle for resolving the doctrinal conflict in the circuits as to the deference due to an agency litigating position interperting an ambiguous regulation.

If the Court grants the petition, it need not delve into the intricacies of the consolidated return regulations in order to decide the case on the merits. Once having resolved the deference issue, the Court would be free to remand to the Third Circuit for consideration of the underlying tax issue on its merits.

II. THE DECISION BELOW TO ACCORD DEFERENCE TO A MERE IRS LITIGATING POSITION INTERPRETING AN AMBIGUOUS TREASURY REGULATION IS INCONSISTENT WITH PROVISIONS OF THE INTERNAL REVENUE CODE THAT ACCORD NO DEFERENCE TO THE MORE DELIBERATIVE LEGAL CONCLUSIONS OF THE TAX COURT AND TO WRITTEN DETERMINATIONS OF THE IRS

In two respects, the decision of the court of appeals is strikingly at odds with the language and structure of the Internal Revenue Code.

A. The Third Circuit Would Accord Greater Deference to an IRS Litigating Position Interpreting an Ambiguous Treasury Regulation Than It is Permitted by Statute to Give to a Legal Conclusion of the Tax Court

In *Dobson v. Commissioner*, 320 U.S. 489, 502 (1943), this Court held that when a court of appeals "cannot separate the elements of a [Tax Court] decision so as to identify a clear-cut mistake of law, the decision of the Tax Court must stand," and that "[i]n deciding law questions courts [of appeals] may properly attach weight to the decision of points of law by an administrative body having special competence to deal with the subject matter." Five years after *Dobson* was decided, Congress repudiated *Dobson*'s holding that reviewing courts must give deference to the Tax Court.[5] The statutory rule in effect since 1948 appears in section 7482(a) of the Code, which provides that "[t]he United States Courts of Appeals . . . shall have exclusive jurisdiction to review the decisions of the Tax Court . . . in the same manner and to the same extent as decisions of the district courts in civil actions

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[5] *See* An Act to Revise, Codify and Enact into Law Title 28 of the United States Code entitled "Judicial Code and Judiciary," Pub. L. No. 80-773, 62 Stat. 869 (1948) (amending section 1141(a) of the Internal Revenue Code of 1939 and explicitly reversing the *Dobson* rule by statute) ("1948 Act"), *reprinted in* 1 U.S.C.C.A.N. A1. *See also* S. Rep. No. 80-1559, at 13 (1948) (stating that Congress intended that the 1948 Act repeal the rule laid down in *Dobson*); 94 Cong. Rec. 8500, 8500-01 (1948) (statements of Rep. Reed and Committee on the Judiciary) (stating that the 1948 Act provides a "much needed correction" that "removes all traces of the *Dobson* decision"); 93 Cong. Rec. A3281 (1948) (statement of Rep. Hobbs) (stating that the *Dobson* decision was "upsetting" and "undesirable" in that it gave "to a body inferior to the appellate courts an unreviewable power of construing tax laws even greater than the regulation-making power given to the Treasury Department, inasmuch as the validity of a Treasury regulation is subject to review by the appellate courts").

tried without a jury . . . ." 26 U.S.C. § 7482(a). Such review, of course, insofar as it involves conclusions of law, is de novo. *See Pierce v. Underwood*, 487 U.S. 552, 558 (1988) ("For purposes of standard of review, decisions by judges are traditionally divided into three categories, denominated questions of law (reviewable de novo), questions of fact (reviewable for clear error), and matters of discretion (reviewable for 'abuse of discretion')."); *accord Ornelas v. United States*, 517 U.S. 690, 701 (1996); *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 947-48 (1995); *Elder v. Holloway*, 510 U.S. 510, 516 (1994).

It remains unexplained why, on the one hand, a court of appeals should defer to a litigating position of the IRS interpreting an ambiguous regulation and, on the other, the same court of appeals should exercise de novo review of the conclusions of law of the Tax Court, which is, by contrast, a neutral arbiter of the rights of a taxpayer. The Third Circuit failed to address this issue, but its resolution of the case stands logic on its head. There is no justification for its according deference to the mere litigating position of the government with respect to an ambiguous regulation when it was barred by statute from deferring to the legal conclusion of the Tax Court, and it was error for the Third Circuit to defer in this case.

B. The Third Circuit Would Accord Greater Deference to an IRS Litigating Position Interpreting an Ambiguous Treasury Regulation Than It Is Permitted by Statute to Give to a "Written Determination" of the IRS

Section 6110(k)(3) of the Code provides that "[u]nless the Secretary otherwise establishes by regulations, a written determination may not be used or cited as precedent." 26 U.S.C. § 6110(k)(3). Treasury Regulations Section

301.6110-2(a), (d), (e), and (f) define "a written determination" to include a private letter ruling, a determination letter, and a technical advice memorandum. 26 C.F.R. § 301.6110-2(a), (d), (e), (f). The Third Circuit did not explain why, on the one hand, a court of appeals should defer to a litigating position of the IRS interpreting an ambiguous regulation and, on the other hand, the same court of appeals is forbidden to treat "a written determination" issued by the IRS as precedent. Indeed, it is incongruous that a court of appeals should defer to the IRS's litigating position although the taxpayer would have been prohibited by statute from even citing, and the court from using, a contrary IRS letter ruling as precedent. The Third Circuit's decision is even more incomprehensible in view of the fact that this statutory proscription against reliance on a written determination applies even if the determination involves the interpretation of an ambiguous regulation.[6] Again, there is no rationale for according greater deference to a litigating position interpreting an ambiguous regulation than to a written determination of the IRS. In fact, there would be every reason to defer more to a written determination than to a mere litigating position interpreting an ambiguous regulation.

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[6] Nothing in *Rowan Cos. v. United States*, 452 U.S. 247 (1981), is inconsistent with the text. In that case, the Court referred to private letter rulings as evidence of the historical position of the IRS, and indicated that the rulings were to be given whatever persuasive force they had. (So too are litigating positions of the IRS.) *Rowan* in no way suggests contrary to the plain language of the statute that private letter rulings are entitled to deference.

III. THE INTERNAL REVENUE CODE DOES NOT PROVIDE FOR OR REQUIRE DEFERENCE TO AN IRS LITIGATING POSITION INTERPRETING AN AMBIGUOUS TREASURY REGULATION, AND IT IS IMPROPER TO ACCORD DEFERENCE TO SUCH A POSITION

In his opinion for a unanimous Court in *Smiley v. Citibank (S.D.), N.A.*, 517 U.S. 735, 740-741 (1996), Justice Scalia, citing *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), explained that courts give deference to regulations, because Congress intended that statutory ambiguity be resolved in the first instance by the agency responsible for administering the statute, "and desired the agency (rather than the courts) to possess whatever degree of discretion the [statutory] ambiguity allows." Justice Blackmun made much the same point in *National Muffler Dealers Ass'n v. United States*, 440 U.S. 472, 477 (1979), a federal income tax case. In explaining why deference should be accorded to Treasury regulations, he referred to section 7805(a) of the Code which provides that "the Secretary [of the Treasury] shall prescribe all needful rules and regulations for the enforcement of this title . . . ." 26 U.S.C. § 7805(a). In short, under both Justice Scalia's and Justice Blackmun's formulations, courts defer to agency regulations that are reasonable interpretations of the statute because Congress said they should defer to such regulations.

Congress, on the other hand, has nowhere directed that courts defer to agency litigating positions interpreting ambiguous regulations. And Congress has not done so for good reason, *i.e.*, because "[t]he deliberateness of such positions, if not indeed their authoritativeness, is suspect." *Smiley*, 517 U.S. at 741. Regulations typically are issued only after compliance with the Administrative

Procedure Act, including full notice and comment. 5 U.S.C. § 553 (1994). Thus, interested parties are afforded the opportunity to express their views by written comment and oral testimony, *see id.* § 553(c), and, in the case of tax regulations, consideration occurs within the Treasury and the IRS at very high levels. *See* Treas. Reg. § 601.601 (*codified* at 26 C.F.R. § 601.601). What we have here, by contrast, is simply the position of a lawyer in the IRS or the Tax Division of the Justice Department which is formulated and expressed only in an adversarial proceeding. No provision of the Code even remotely suggests that deference is to be accorded to such a position.[7]

If there is to be judicial deference to the government's litigating positions concerning ambiguous regulations, *all* courts would have to defer, not just the circuit courts. As a result, once a district court or the U.S. Claims Court or the Tax Court deferred, there would be little left for a circuit court to do. Although Congress repealed the *Dobson* doctrine by its enactment of section 7482 of the Code, the doctrine espoused below—that courts must defer to the government's litigating positions with respect to ambiguous regulations—has the effect of partially nullifying that fifty-one year old provision of law.

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[7] This Court long ago recognized that regulations are in a category of respect that far exceeds the respect due to other administrative pronouncements. In deciding for the taxpayer in *Commissioner v. Tellier*, 383 U.S. 690 (1966), the Court explained that the Commissioner's "view finds considerable support in other administrative and judicial decisions It finds no support, however, in any *regulation* or statute or in any decision of this Court . . . ." *Id.* at 691 (emphasis supplied) (footnote omitted).

IV. THE RULE ADOPTED BY THE THIRD CIRCUIT IS A SERIOUS THREAT TO PROPER TAX ADMINISTRATION

In the tax area, the Third Circuit's decision raises particularly serious problems involving the proper administration of the Code. These problems arise for two reasons. The first is the sheer volume and complexity of the regulations promulgated by the Treasury Department. The second arises from the fact that the IRS frequently finds itself in a position where its line attorneys, or those from the Justice Department, must assert inconsistent positions in order to protect the government from being whipsawed.

Because of the volume of tax regulations and because many of these regulations contain ambiguities, the implications of the Third Circuit's decision in the tax area are breathtaking. In every case of ambiguity, the court would not be seeking the better of the two interpretations advanced by the parties, but would only have to determine whether the interpretation advanced by the IRS was reasonable and could sustain that interpretation even if the taxpayer's interpretation was more consonant with the language and scheme of the statute. This tipping of the scales in favor of the IRS would have a profound effect on the outcome of tax cases, and should not be permitted to occur without some indication from Congress that this is its intention. Insofar as we are aware, Congress has never given any such indication and, as discussed above in Parts II and III of this brief, all congressional signs are to the contrary. This Court has not addressed the question in detail. We are aware of only a single brief passage in which the Court mentioned the issue in a tax case. In *Cottage Sav. Ass'n v. Commissioner*, 499 U.S. 554, 562-63 (1991), the Court suggested that deference was not due to an IRS litigating position interpreting an ambigu-

our regulation where "the Commissioner has not issued an authoritative, prelitigation interpretation."

The IRS has a need to protect itself from whipsaw, and that need exacerbates the administrative problems. For example, a husband may be paying deductible alimony and nondeductible child support to his former wife, and a dispute may arise as to how the total payment should be allocated between the two categories. *See Commissioner v. Lester*, 366 U.S. 299 (1961). The IRS will not want to be in a position of having a large portion of the payment treated as deductible alimony in the husband's case, but as excludable child support in the former wife's case. To protect against this eventuality, the IRS may take an inconsistent position in the two cases, each in a different circuit, asserting in the husband's case that most of the payment is nondeductible child support, and in the former wife's case that most of the payment is taxable alimony. If the criteria for allocating between alimony and child support are prescribed in an ambiguous regulation,[8] under the Third Circuit's rule, the inconsistent IRS positions would both be accorded deference, and both the husband and his former wife would lose.

A similar situation can arise in the case of run-of-the-mill property valuations. To protect against whipsaw, the IRS may place a high value on property for estate tax purposes and a low value on the same property for purposes of calculating an income tax charitable deduction. *See United States v. Cartwright*, 411 U.S. 546 (1973). If the valuation procedure is prescribed in an ambiguous regulation,[9] presumably both IRS valuations would be ac-

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[8] *See* Temp. Treas. Reg. § 1.71-1T A-14, A-17.

[9] *See* Treas. Regs. §§ 1.170A-1(C), 20.2031 & 20.2032 (*codified at* 26 C.F.R. §§ 1.170A-1(C), 20.2031 & 20.2032).

corded deference under the standard applied by the court below.

The same type of problem can arise in the case of more complicated corporate transactions. The question may be whether a distribution in redemption of stock is essentially equivalent to a dividend or is to be considered in part or full payment in exchange for the stock. *See United States v. Davis*, 397 U.S. 301 (1970). Again, the IRS may be subject to whipsaw between an individual shareholder who wants the redemption treated as an exchange, which will produce favorable capital gains treatment, and a corporate shareholder which desires dividend characterization in order to take advantage of the deduction for intercorporate dividends. Under the decision of the Third Circuit, if the controlling regulation for differentiating between an exchange and a dividend is ambiguous,[10] the inconsistent (albeit not unreasonable) positions taken by the IRS in each case would be accorded deference in the taxpayers' respective circuits.

Numerous other examples of whipsaw could be given, but these few should suffice to illustrate the problem. If the Third Circuit's decision were followed in whipsaw cases, the IRS might prevail on both sides of these cases. Such inconsistent results would be harsh and unfair, and should not be allowed to occur.

* * * *

The essence of the case is this. The court of appeals did not reach its own decision on the legal issue before it. Confronted by an ambiguous regulation and no prelitigation interpretation of that regulation, the court abdicated its responsibility by rendering judgment on the basis of deference to the IRS's litigating position. Parties facing

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[10] *See* Treas. Reg. 1.302-1 (*codified at* 26 C.F.R. § 1.302.1).

the government in litigation are entitled to have the courts reach their decisions based on the merits.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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IN THE

Supreme Court of the United States

CONNECTICUT GENERAL LIFE INSURANCE COMPANY, *et al.*,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

ARGUMENT 1

CONCLUSION 8

TABLE OF AUTHORITIES

Page

Cases

AMP, Inc. v. United States, 185 F.3d 1333 (Fed. Cir. 1999) 6

Bowen v. Georgetown University Hospital, 488 U.S. 204 (1988) 1

CSI Hydrostatic Testers, Inc. v. CIR, 103 T.C. 398 (1994), *adopted and aff'd*, 62 F.3d 136 (5th Cir. 1995) (per curiam) 6

Freytag v. CIR, 501 U.S. 868 (1991) 6

Gardebring v. Jenkins, 485 U.S. 415 (1988) 2

Gould v. Gould, 245 U.S. 151 (1917) 6

Granfinanciera, S.A. v. Nordberg, 492 U.S. 33 (1989) . . 4

Martin v. OSHRC, 499 U.S. 144 (1991) 6

Matsushita Electric Industrial Co. v. Epstein, 516 U.S. 367 (1996) 4

Moskal v. United States, 498 U.S. 103 (1990) 3

Public Citizen v. Carlin, 184 F.3d 900 (D.C. Cir. 1999) 7

Robertson v. Seattle Audubon Society, 503 U.S. 429 (1992) 3

Statutes and Regulations

5 U.S.C. § 554(a)(1) 6

26 U.S.C. §1503(c)(2) 5

26 U.S.C. § 6213(a) 5

Rules of Practice and Procedure for the United States Tax Court, 26 U.S.C. foll. § 7453 5

26 C.F.R. § 1.1502-47(m)(3)(vi) . . . . . *passim*

26 C.F.R. § 1.1502-47(m)(4) . . . . . *passim*

REPLY BRIEF FOR PETITIONERS

1. The brief in opposition scarcely even mentions the question decided by the court of appeals and presented in the petition for certiorari. The court of appeals unequivocally held that courts must defer to agency litigating positions interpreting ambiguous *regulations* (Pet. App. 14a-15a), even though *Bowen v. Georgetown University Hospital*, 488 U.S. 204, 212-13 (1988), prohibits deference to agency litigating positions interpreting ambiguous *statutes*. The petition for certiorari demonstrated that the court of appeals' holding creates two independent circuit splits (Pet. 9-16), conflicts with several of this Court's administrative law and tax decisions (Pet. 16-23), and addresses a question of surpassing national importance (Pet. 23-27). The IRS's observation that there is no circuit conflict regarding construction of 26 C.F.R. §§ 1.1502-47(m)(3)(vi) and (m)(4) (Opp. 7) misses the point that there *is* a circuit conflict on the far more important question whether courts must defer to agency litigating positions interpreting ambiguous regulations. The IRS disputes neither the existence nor the importance of that broader circuit conflict. As twelve extraordinarily diverse *amici* have explained, that broader conflict plainly warrants this Court's attention:

> What is specifically at stake here is the balance of litigating power between taxpayer and tax collector in a large number of cases—those involving the proper interpretation of ambiguous Treasury regulations—and, more generally, between the regulator and the regulated in all areas in which federal regulatory power is exercised and the government's regulation is ambiguous. This is a fundamental issue that is worthy of this Court's consideration.

Brief *Amici Curiae* of the American Council of Life Insurance *et al.* at 7 (filed Oct. 12, 1999).

2. The IRS opposes review based on grounds neither decided by the court of appeals nor raised in the petition for certiorari. Specifically, the IRS contends that its disputed

interpretation was compelled by the "plain language" of the relevant tax regulations (Opp. 10-11) and was authoritatively expressed prior to the tax court litigation in this case (Opp. 11-12). These arguments are unsound at every turn: they ignore the question actually decided by the court of appeals, one of them is untimely, and both of them are meritless.

a. The IRS's argument about the merits of the underlying interpretive dispute (Opp. 10-11) is entirely beside the point, for the court of appeals did not reach that question. As explained in the petition (Pet. 3-6), the underlying dispute involves a question whether the appropriate tax treatment for acquired groups is governed by 26 C.F.R. § 1.1502-47(m)(3)(vi), which establishes a general consolidation rule for any nonlife "member," or by 26 C.F.R. § 1.1502-47(m)(4), which "[r]eserved" the consolidation question in the specific context of "[a]cquired groups."[1] The court of appeals did not itself interpret either provision. Instead, it held only that the competing interpretations were "equally likely" (Pet. App. 16a), and that the IRS's litigating position was therefore entitled to deference (Pet. App. 16a-17a). Indeed, the court of appeals repeatedly limited its analysis to deference issues. *E.g.*, Pet. App. 1a-2a (deferring to IRS's "permissible interpretation"); Pet. App. 13a-15a (discussing deference holdings of *Bowen* and *Gardebring v. Jenkins*, 485 U.S. 415, 430 (1988)); Pet. App. 15a ("we will defer to the IRS's interpretation"); Pet. App. 23a (deferring because IRS interpretation "is not so unreasonable as to be declared invalid by this court").

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[1] As the court of appeals summarized the competing contentions, petitioners construed subsection (m)(4) as a reservation of the acquired group "subject matter" (and thus argued that the sepcific provisions of subsection (m)(4) qualify the general provisions of subsection (m)(3)(vi)), while the IRS construed subsection (m)(4) as a reservation only of "space" for possible future regulations (and thus argued that the general provisions of subsection (m)(3)(vi) qualify the specific provisions of subsection (m)(4)). Pet. App. 15a-16a.

Petitioners seek review of the deference question that the court of appeals did resolve, not the underlying interpretive dispute that it expressly did not reach.

In any event, the IRS errs in contending that its disputed interpretation is compelled by the plain meaning of the regulations. By applying subsection (m)(3)(vi) both to individually-acquired companies and to acquired groups, the IRS's litigating position violates the basic interpretive presumption that "specific provisions qualify general ones," *Robertson v. Seattle Audubon Soc.*, 503 U.S. 429, 440 (1992), and that courts must "give effect, if possible, to every clause or word" of a statute or regulation, *Moskal v. United States*, 498 U.S. 103, 109-10 (1990) (quotation omitted). At a minimum, these principles establish a reasonable interpretive dispute about whether the acquired group issue is governed by subsection (m)(3)(vi) or by subsection (m)(4). The court of appeals resolved that dispute not by construing those provisions itself, but by deferring to the IRS's litigating position.[2]

b. The IRS also errs (Opp. 11-12) in opposing review on the ground that it had authoritatively expressed the disputed interpretation prior to this litigation. The court of appeals did not defer on the ground that the IRS had expressed its interpretation prior to the litigation. Instead, it deferred on the ground that an administrative interpretation of an ambiguous regulation is entitled to deference "even when that interpretation was proffered for the first time in litigation."

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[2] Contrary to the IRS's suggestion, this Court would not need to resolve the underlying interpretive dispute on the merits were it to grant review on the deference question presented. If this Court were to hold that the court of appeals improperly deferred to the IRS's litigating position, it could, if it desired, simply remand the case for the court of appeals to impose its own best construction of subsections (m)(3)(vi) and (m)(4), and of 26 U.S.C. § 1503(c)(2).

Pet. App. 15a. Again, the IRS simply ignores the question decided below and raised in the petition for certiorari.

The IRS also failed to preserve this contention below. In the court of appeals, petitioners argued that the IRS's disputed interpretation was a "litigating position" that, under *Bowen*, was not entitled to deference. Brief for Petitioners-Appellants at 28, *Connecticut General Life Ins. Co. v. CIR*, CA3 No. 97-7612 (filed April 15, 1998). The IRS's sole argument in response was that, because the plain meaning of the regulations compelled its interpretation, no deference question was presented. Brief of Appellee at 21-34, *Connecticut General Life Ins. Co. v. CIR*, CA3 No. 97-7612 (filed May 29, 1998). The IRS did not raise below and the court of appeals did not address any argument for deference based on the IRS's pre-litigation positions. Therefore, the IRS cannot raise that argument here. *See, e.g., Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367, 379 n.5 (1996); *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 38-39 (1989).

In any event, the IRS's argument for deference based on its pre-litigation positions is plainly without merit. The very studies now trumpeted by the IRS (Opp. 11) demonstrate that, prior to this litigation, the IRS had interpreted the regulations in a manner directly contrary to its current litigating position. Those studies reveal that the IRS has long recognized that subsection (m)(3)(vi) could be read either to govern acquired groups, an interpretation described by the IRS in its studies as "alternative one," or not to govern acquired groups, an interpretation described by the IRS as "alternative two." Supp. App. 3a.[3] They further reveal that the IRS not only sought to codify "alternative two" in unambiguous new regulations, but also concluded that "alternative two" was the *more* plausible

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[3] The supplemental appendix to this reply brief ("Supp. App.") reproduces a memorandum (CA3 App. 204-14) setting forth the IRS's pre-litigation interpretation of subsections (m)(3)(vi) and (m)(4).

interpretation of the *existing* regulations (*i.e.*, subsections (m)(3)(vi) and (m)(4)). Supp. App. 5a. The IRS thus affirmatively embraced the position urged in this case by petitioners:

> *Treat the reservation for acquired groups at § 1.1502-47(m)(4) as meaning that there was no rule in effect* for taxable years for which returns were due prior to the formal adoption of alternative two. . . . For periods for which no rule is in effect, any reasonable interpretation of [26 U.S.C.] section 1503(c)(2) as applied to acquired groups (including the interpretation of either alternative one or alternative two) will be acceptable.

Supp. App. 5a (emphasis added).[4]

Equally meritless is the IRS's plea for deference (Opp. 12) based on the position it had staked out during petitioners' audit. The IRS's audit positions are not entitled to deference, because Congress has explicitly provided that any deficiency assessed during an audit is subject to a *de novo* "redetermination" in the United States Tax Court. 26 U.S.C. § 6213(a); *see* Rules of Practice and Procedure for the United States Tax Court, 26 U.S.C. foll. § 7453 (providing for *de*

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[4] The "alternative two" position previously embraced by the IRS, and urged in this litigation by petitioners, reflects a reasonable interpretation of the governing statute, 26 U.S.C. § 1503(c)(2), which provides only that the losses of a recently-acquired nonlife member "shall not be taken into account" for the specific purpose of "determining the taxable income of a member taxed under section 801" (*i.e.*, a life member). Petitioners used the relevant losses not to offset the *life* income of CGL, but only to offset the *non*-life income of members of the INA Group and the PHC Group. Pet. 6-7. In its pre-litigation studies, the IRS conceded that this interpretation of § 1503(c)(2) is both "reasonable" and "acceptable." Supp. App. 5a.

novo trials); *Freytag v. CIR*, 501 U.S. 868, 890-91 (1991).[5] Thus, the Fifth Circuit has held that *Bowen* prohibits deference to IRS litigating positions asserted in the United States Tax Court, *see CSI Hydrostatic Testers, Inc. v. CIR*, 103 T.C. 398, 408-09 (1994), *adopted and aff'd*, 62 F.3d 136 (5th Cir. 1995) (per curiam), even though such litigation necessarily involves review of an audit and the resulting "deficiency," *see id.* at 399. Similarly, the Federal Circuit has refused to defer to IRS interpretations "issued at a time when the I.R.S. is preparing to litigate," *AMP, Inc. v. United States*, 185 F.3d 1333, 1338 (Fed. Cir. 1999), a rule that obviously precludes deference to IRS audit positions.

c. In response to petitioners' further contention that any ambiguity in the regulations should be resolved in favor of taxpayers, the IRS argues that *Gould v. Gould*, 245 U.S. 151 (1917), and its progeny were implicitly overruled in 1938. Opp. 12-13. However, at least seven courts of appeals have continued to apply those decisions. Pet. 12-14 & n.9 (collecting cases). The IRS also argues that, in any event, *Gould* is inapplicable because this is a "deductions" case. Opp. 13-14. However, the consolidation questions presented here have nothing to do with the scope of any particular deduction.[6]

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[5] Because any deficiency assessed during an audit is "subject to a subsequent trial of the law and the facts de novo in a court," taxpayers receive none of the procedural protections that customarily apply during administrative adjudication. 5 U.S.C. § 554(a)(1). Moreover, because Congress explicitly authorized *de novo* review of audit determinations, a tax audit also is fundamentally unlike the administrative adjudication at issue in *Martin v. OSHRC*, 499 U.S. 144, 154-55 (1991), where Congress was presumed to have authorized only a more limited standard of review "for consistency with the regulatory language and for reasonableness."

[6] As noted above (*see supra* note 2), were this Court to grant certiorari and hold that the court of appeals improperly deferred to the IRS's litigating position, it could, if it desired, simply remand the case for the court of appeals to resolve these other interpretive disputes.

3. As demonstrated in the petition for certiorari (Pet. 9-11), at least five courts of appeals have held, in direct conflict with the decision below, that *Bowen* prohibits deference to agency litigating positions interpreting ambiguous regulations. A recent decision from another court of appeals has exacerbated this circuit conflict. In *Public Citizen v. Carlin*, 184 F.3d 900 (D.C. Cir. 1999), the D.C. Circuit deferred to an agency litigating position interpreting an ambiguous regulation promulgated by the Archivist of the United States. "That the Archivist's interpretation comes for the first time in litigation," the D.C. Circuit concluded, "does not make it unworthy of deference." *Id.* at 911. The Third Circuit decision cannot be brushed aside as an aberrational result subject to explanation on meritless grounds that the Third Circuit never considered. The circuit conflict is real, is worsening, and is now ripe for resolution in this Court.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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SUPPLEMENTAL
APPENDIX

Internal Revenue Service
MEMORANDUM
CC: LR-128-83
Br2: KEStanley
Date: [Preliminary draft of 6-18-85]

To: Review Group

From: Director, Legislation and Regulations Division

[illegible]: Life-Nonlife Consolidated Returns: CIGNA Issue

Section 1503 (c) (2) provides a limitation on the use of nonlife company losses against life company income on a life-nonlife consolidated return.

STATUTES

Section 1503 (c) (1) provides as a general rule that the consolidated net operating loss of nonlife members (nonlife CNOL) that cannot be carried back against nonlife income may reduce life income (in year the loss arises or as a carryover) but only to the extent of 35 percent of the lesser of the nonlife CNOL or the consolidated life company income.

Section 1503 (c) (2) provides that, notwithstanding section 1503 (c) (1), "a net operating loss" for a taxable year for a nonlife company "shall not be taken into account in determining the taxable income" of a life company unless the loss arises after the nonlife company has been a member for five years.[1]

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[1] There is another "five-year rule" in section 1504 (c) (2). While life companies are not generally treated as members of groups that contain nonlife companies, a life company may be included in a life-nonlife consolidated return, but only if the life company has otherwise been a member of the group for five years.

This memorandum uses the term "ineligible nonlife member" to identify a non-five-year nonlife company.

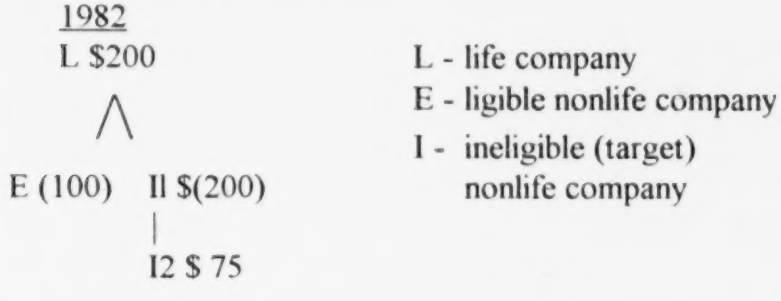
ISSUE, ILLUSTRATION, AND ALTERNATIVES

Issue

In interpreting section 1503 (c) (2), under what circumstances does proper policy dictate that the taxable income of an ineligible nonlife member reduces the net operating losses (NOLs) of other ineligible nonlife members rather than first being used to reduce the NOLS of eligible nonlife members? This issue arises frequently in the consolidated return context, *i.e.*, whether to treat more than one corporation as one entity (single economic entity approach) or to treat them as separate entities (separate entity approach).

Illustration

Assume that L, below, purchases on January 1, 1982, the stock of Il which owns I2 and that I1 and I2 filed a consolidated return prior to their acquisition.



The nonlife CNOL for 1982 is $225, *i.e.*, ($100) + ($200) + $75. If it is assumed that E has no prior year income against which any of the nonlife CNOL could be absorbed as a carryback, then any nonlife CNOL attributable to E (but not to Il) is eligible for use against L's income. How is I2's income applied against the losses of E and I1?

Alternatives

Alternative One (Separate Entity Approach):

Apply section 1503 (c) (2) on a separate entity approach across-the-board. If I1 and I2 were unrelated prior to their independent acquisition by L, the portion of the nonlife CNOL attributable to E would be $25 under the current life-nonlife regulation (§ 1.1502-47 (m) (3) (vi)), *i.e.*, nonlife CNOL of $225 reduced under section 1503 (c) (2) by "not taking into account" I1's NOL of $200. This same rule can be applied even though I1-I2 filed a consolidated return prior to acquisition by L. In such a situation, I2's income in 1982 in effect is applied first against the "eligible" NOL of E. Thus, $200 of the nonlife CNOL is attributable to I1 and $25 of the nonlife CNOL is eligible for use against life income.

Alternative Two (Economic Entity Approach):

Apply section 1503 (c) (2) by treating I1 and I2 as a single economic entity. If I1 and I2 were treated as a single economic entity in 1982, E's share of the $225 nonlife CNOL would be $100, i.e., $225 reduced by the $125 CNOL of the I1-I2 "economic entity."

BACKGROUND

The issue presented in this memorandum was first raised by the CIGNA life-nonlife insurance group only about a month prior to the 3-14-83 deadline for promulgation of the final life-nonlife regulations. The proposed life-nonlife regulations had provided for the use of alternative one in all cases. CIGNA argued that alternative two be adopted for certain acquired nonlife groups.[2]

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[2] CIGNA's facts are that in March, 1982, the holding companies of Connecticut General (CG, primarily a life group but with substantial casualty subsidiaries) and Insurance Company of North America (INA, almost exclusively a casualty group) consolidated into a new entity,

When this issue was presented to the Commissioner a few weeks prior to 3-14-83, he was sympathetic on policy grounds with the use of alternative two in certain cases. However, because those people briefing the Commissioner believed at the time that it was questionable whether there was legal authority to adopt alternative two, the Commissioner decided to go with alternative one's literal reading of the statute for all cases.[3] Nonetheless, the final regulations specifically reserved a rule, entitled "acquired groups," and the preamble indicated that the Treasury would study the issue.[4]

There is no clear-cut, winning argument for either alternative one or alternative two. The legislative history is scanty. Either alternative is viable. Treasury is on record as supporting alternative two.[5]

CIGNA. Former shareholders of CG received about 52 percent of CIGNA stock, resulting in CG being considered the acquiring group and its casualty companies the "eligible" nonlife companies (which had net losses of about $140 million). Former shareholders of INA received the remainder of CIGNA stock and each former INA casualty company is "ineligible" (ineligible taxable income was about $110 million and ineligible NOL's were about $170 million for a net loss of $60 million). For 1982, CIGNA's nonlife CNOL was about $200 million and consolidated life income was about $82 million. Prior to the consolidation, it is not clear whether CG or INA was the larger group.

[3] It is now, however, sufficiently clear that the Secretary does have authority to adopt alternative two. See pp. 5-7 of this memorandum.

[4] The final regulations at § 1.1502-47 (m) (3) (vi) (A) adopts alternative one as the general rule. The final regulations at § 1.1502-47 (m) (4) reserves space for possible future special treatment for "acquired groups." The preamble to the final regulations at 48 FR 11440 discusses these points. See Appendix B.

[5] See Appendix E for copies of two memoranda from Treasury on this issue.

PROPOSED RESOLUTION

The following recommendations are made:

(1) Adopt alternative two for prospective application. The position should be published as a proposed regulation. See section 1503 (a).

(2) Treat the reservation for acquired groups at § 1.1502-47 (m) (4) as meaning that there was no rule in effect for taxable years for which returns were due prior to the formal adoption of alternative two. See section 1503 (a). For periods for which no rule is in effect, any reasonable taxpayer interpretation of section 1503 (c) (2) as applied to acquired groups (including the interpretation of either alternative one or alternative two) will be acceptable.

LEGAL AUTHORITY

It is arguable that alternative one follows the "plain meaning" of the words of section 1503 (c) (2). Thus, the Service has legal authority to adopt this alternative under section 7805. The Service probably also has legal authority under section 1502 to adopt alternative two.

Alternative One

Section 1503 (c) (2) states, in part, that "a net operating loss ... of [an ineligible nonlife member] ... shall not be taken into account in determining the taxable income of [an eligible life member]...". Alternative one deals with the existence of ineligible nonlife loss members by comparing the situation as it would exist in the absence of such members with the situation as it actually exists once such members are included. In this way, this alternative arguably follows the "plain meaning of section 1503 (c) (2) which provides that the NOL of an ineligible nonlife member is not to be taken into account.

Alternative Two

While the Service probably has legal authority under the broad legislative grant of section 1502 to adopt alternative two, it is arguable that the "plain meaning" of section 1503 (c) (2) overrides the general authority of section 1502, especially since section 1503 (c) (2) is a specific, later-enacted consolidated return statute. There is, however, nothing conclusive in the legislative history to indicate whether Congress would have, had it considered the issue, preferred alternative one or two. Furthermore, the meaning of section 1503 (c) (2) is not perfectly "plain".[6] Accordingly, it is not at all unreasonable to conclude that the Secretary has authority under the broad section 1502 delegation of authority (discussed below) to adopt alternative two. It is arguable also that the delegation of authority to the Secretary in the first sentence of section 1503 (c) (1) is sufficient to permit the adoption of alternative two.

Section 1502 authority. The Secretary has a broad legislative grant of authority under section 1502 as to how to take income and losses of the group's members into account. Section 1503 (c) (2) arguably is silent on how to take an ineligible nonlife member's income into account. The Service position is that the Secretary has authority under section 1502 to develop ordering rules for absorption of a particular member's income. For example, § 1.1502-42, T.D. 7876, filed March 14, 1983, adopted a subgroup method under that authority for purposes of determining bad debt deductions for thrift institutions filing consolidated returns. A subgroup method for life-nonlife returns would treat certain ineligible nonlife members as a subgroup for purposes of first off-setting

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[6] The now-rejected allocation approach in alternative three (set forth at pages 4-5 of the 2-1-85 memorandum to the Review Group) arguably also is, along with alternative one, a "plain meaning" approach to section 1503 (c) (2). The existence of more than one "plain-meaning" approach means that the meaning actually is not perfectly "plain."

the income of one or more of its members against the losses of one or more other members of that subgroup. Thus, that subgroup would essentially be treated as if it were a single member for purposes of applying section 1503 (c) (2).

The Service has already used its broad section 1502 authority in a closely related context. That is, in the life-nonlife regulations at § 1.1502-47, the Service takes the position that it can use its section 1502 authority to provide an expansive definition of the term "member" to effectuate the two five-year rules.[7] Basically, the regulations provide (through their definition of eligible corporation at § 1.1502-47 (d) (12)) that for purposes of sections 1503 (c) (2) and 1504 (c) (2) a corporation is not considered a five-year member unless, in addition to formal existence for the five-year period, it also meets certain other requirements, including, for example, that it not have undergone a "disproportionate asset acquisition" during the five-year period. Thus, the Service has taken an expansive view of the term member in order to prevent taxpayers from circumventing the Congressional intent behind the five-year rules.

Alternative two would, under certain circumstances, treat an acquired nonlife subgroup of members as a single member. Because alternative two is merely another kind of expansive reading of the term "member," it is consistent for the Service to assert that it has authority under section 1502 to adopt alternative two, provided this would reach a more desirable policy result.

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[7] See footnote 1 on page 1 and the accompanying text.

POLICY COMPARISON OF ALTERNATIVES ONE AND TWO

Equity vs. Competition

On the one hand, alternative one appears inequitable if, as the result of an acquisition of a nonlife group having a CNOL, the eligible CNOL of the combined group is less than the eligible CNOL of the acquiring group would have been had the acquisition not been made. For example, using the illustration on p. 2 of this memorandum, under alternative one the acquisition of the 11-12 group, which has a $125 CNOL, reduces what otherwise would have been $100 of eligible CNOL of the acquiring group to $25. If 11-12, however, were able to consolidate into a single corporate shell having a $125 NOL, the result would be an eligible nonlife CNOL of the combined group of $100.

On the other hand, the 5-year rules of sections 1503 (c) (2) and 1504 (c) (2) probably reflect Congressional concern that permitting unrestricted life-nonlife consolidation would have a detrimental impact relating to maintaining competition in the insurance industry generally (i.e., antitrust type concerns).[8] The stronger this Congressional intent, the more justification

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[8] While the legislative history is scanty and does not specifically state what Congressional concern prompted the enactment of the 5-year rules, it seems quite likely that these rules were developed by the Conference Committee in part as a compromise in response to the Senate floor debate on the competition issue. See 122 Cong. Rec. 24,680-90 (1976). That is, agreement was reached that life-nonlife consolidation would indeed be permitted but that the 5-year rules would be inserted to reduce anti-competitive effects, notwithstanding the fact that the 5-year rules to some extent reduce the benefits of consolidation. Congress apparently did not want to go too far in encouraging either the acquisition by life groups (*i.e.*, groups containing one or more life members) of nonlife members or the acquisition by nonlife groups (i.e., groups containing one or more nonlife members) of life members.

there is for the application of alternative one to the acquisition of I1-I2. That is, if this concern is strong, Congress arguably would rather provide a rule (alternative one) that does not encourage the acquisition of the entire I1-I2 group[9] than provide a rule (alternative two) that would treat the acquired businesses of the I1-I2 group in the same way they would have been treated had those businesses instead been organized in a single corporate shell.[10]

It is not clear, however, how strongly Congress was concerned about the anti-competitive effects of life-nonlife acquisitions. The only evidence of concern is the (non-self-evident) language of the statute itself and the dialogue of the Senate floor debate, during which the anti-competition argument was seriously raised by one side but was, by the opposing side, considered relatively unimportant compared to the benefits to be derived from life-nonlife consolidation.

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[9] If the acquiring group (L-E) were primarily interested for business reasons in acquiring only either I1 or I2, alternative two would provide some encouragement to also acquire the member in which it was less interested. Thus, for example, if L-E were primarily interested in acquiring I2, there would be a somewhat greater interest in also acquiring I1 (than there otherwise would have been) in order to offset I2's income, thereby "freeing-up" E's eligible loss.

[10] Furthermore, to the extent that there are legitimate business reasons for organizing businesses in the form of a group (I1-I2) as opposed to within a single corporate shell (I), the taxpayers (I1-I2 vs. I) are not similarly situated, and a difference in tax treatment upon acquisition is not inequitable. In many cases there may be good business reasons for organizing the businesses as I1-I2 rather than as I. For example, it may be desirable to conduct different lines of business in different corporate shells. In the casualty industry, because the stringency of state law requirements (relating to reserves and other matters) varies considerably from state to state, it is sometimes economically desirable to sell even a single line of insurance through several corporations, each incorporated in a state different from the others. Admittedly, however, there are also many cases where the form of organization (I1-I2 vs. I) is more or less fortuitous.

While the enactment of the 5-year rules and of the 35% limitation on the offset of nonlife loss against life income has probably had a dampening effect on certain acquisitions, the adoption of alternative two rather than alternative one is unlikely to be a great stimulus for such acquisition activity because the tax difference between the two alternatives is likely to be a minor factor in comparison to other factors determining the desirability of such an acquisition.

Accordingly, it would not be unreasonable to adopt alternative two for acquired nonlife groups on the rationale that the equity argument is entitled to greater weight than the countervailing anti-competition argument.

Formalistic Consolidations

Another reason for preferring alternative two for acquired nonlife groups is that the adoption of alternative one would, in certain cases, encourage purely formalistic consolidations of the acquired group into a single corporate shell in order to obtain the result that would have occurred had alternative two been adopted. This is not, however, a very strong argument because there are probably not very many cases where it would be feasible to consolidate the acquired group merely to obtain that result.[11]

Other Arguments

Other arguments against the economic entity approach raised by the 2-1-85 memorandum to the Review Group subsequently appear to be relatively insubstantial. These arguments include the SRLY rule inconsistency argument (see Appendix A for an in-depth discussion), the reinsurance argument (see Appendix D), and the outdated section 818 (f)

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[11] See Appendix C for a discussion of the feasibility of consolidation of acquired nonlife groups.

(2) argument (old section 818 (f) (2) is not effective for taxable years beginning after 1984).

RECOMMENDED SCOPE OF ALTERNATIVE TWO

Under alternative two, an acquired "economic entity" is to be treated as a single member of the acquiring group for the purposes of applying section 1503 (c) (2). For these purposes it is recommended that the acquisition of an "economic entity" be considered to occur only where an entire affiliated group that was included on a consolidated return is acquired by acquiring the common parent. While a broader definition of "economic entity" would be theoretically correct,[12] adoption of the broad definition is not recommended for two reasons. First, it would involve either the subjectivity of a "single transaction" test or the requirement of an arbitrary time period such as the complex, one-year consistency period in section 338 (h) (4). Second, it would lend a greater flexibility to tax-motivated acquisition planning by allowing the acquiring group to "pick and choose" among the members of a disposing group.

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[12] Under the broadest theoretically correct definition of "economic entity," two or more acquired members would be treated as an "economic entity," provided that those acquired members were acquired in a *single transaction* from an affiliated group and were included in a consolidated return filed for the period which included the acquisition date. Under this broad definition of "economic entity," the equity argument continues to be valid because, had that "economic entity" instead fortuitously been organized within a single corporate shell, there could well have been a significant difference in the amount of eligible nonlife loss computed under section 1503 (c) (2) (even though the form of organization would make little difference in the computation of aggregate net income or loss).